

The OECD Model Tax Convention

Explaining the OECD's legitimization strategies and why states adhere to the principle of exclusive rights to tax royalties in the state of residence

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Abstract

Although taxation matters are generally accepted to be an issue of national concern, increasing attention is paid to international efforts at conforming and standardising taxation systems internationally. In a global economy where national borders are becoming less important for economic activity, this shift in focus is only appropriate. In order to deal with double taxation as a barrier to trade and investment, taxation treaties are negotiated between states to allow for predictable taxation for companies and individuals pursuing economic activity across national borders. The Model Tax Convention, published regularly by the Organisation for Economic Co-operation and Development (OECD), is one of the most important documents for harmonising international taxation systems, and provide a basis for negotiations between states.

The aim of this thesis is to investigate how and why the Model Tax Convention has become an important tool internationally, despite the limited membership of the OECD. It finds that through a strategy of portraying the Model Tax Convention as the obvious choice for policy-makers, the OECD has legitimated the Model. However, this strategy has not had the desired effect on states, which do not necessarily adhere to the propositions encouraged by the OECD. Rather, states seem to make reservations towards the Model Tax Convention if they feel that its content does not satisfy their self-interests. This thesis furthermore finds that, depending on the countries negotiating, the outcome of negotiations over taxation treaties is determined by either the most powerful state or by moral considerations.

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I take full responsibility for any mistakes or omissions in this thesis.

Guro Klausen

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1 Introduction

1.1 Introduction

Double taxation arises when two or more states impose a tax on the same taxpayer for the same subject matter. The imposition of double taxation is commonly recognised to be a burden for economic actors attempting to pursue activities across national borders. When tax authorities in several states impose taxation on economic activity this can be a disincentive to invest, trade or otherwise carry out transactions across borders. This thesis will deal with efforts made towards dealing with double taxation, particularly the efforts of the Organisation for Economic Co-operation and Development (OECD). In this introductory chapter I will give a brief historical account of the Model Tax Convention adopted by the OECD, before I outline the research questions of this thesis and show how and why these questions are of particular relevance. Lastly this chapter will explain how the research questions will be answered, and outline the structure of this thesis.

1.2 Historical Background

The mission of the Organisation for Economic Co-operation and Development (OECD) is to promote policies that will improve the economic and social well-being of people around the world (oecd.org, 2014). The OECD was officially created in 1961 after the OECD Convention between the Organisation for European Economic Cooperation (OEEC), the United States and Canada was signed in 1960. Before 1961, the OEEC existed in Europe to run the Marshall Plan for reconstruction after World War II which was financed by the USA. Today the OECD has 34 member countries from all continents except Africa. The OECD today address problems in the international environment, discuss and analyse them, and promote policies aimed to solve the problems (oecd.org, 2014).

Official efforts to deal with the issue of double taxation were first initiated in 1922 by the League of Nations, who conducted a study of the issue lead by its Committee of Technical

Experts (Kragen, 1964: 307). A few, mainly unilateral, efforts had been made by individual states before this to decrease double taxation, but this study represented the first concerted effort, and resulted in a draft of a model for double taxation treaties in 1928 (Kragen, 1964: 307). The idea behind models for double taxation treaties is that these conventions represent a consensus among experts or states as to how bilateral taxation treaties should be constructed to decrease double taxation. They are primarily a tool for negotiators to use rather than having to negotiate the content of taxation treaties from scratch in each case where there is a need for taxation treaties between two or more states (Appendix 2, 2014 [interview]). The first draft written by the Committee of Technical Experts of the League of Nations was expanded and revised which led to two more Model Conventions being concluded in Mexico (1943) and London (1946) (OECD, 2012: 7). Neither of these Model Conventions were accepted unanimously, and the three models presented dissimilarities on the policies promoted in order to deal with double taxation.

In 1956 the Fiscal Committee of the OEEC set out to study the fiscal questions relating to double taxation (Kragen, 1964: 307). In the 1950s the OEEC was the organisation which was available and had the interest in continuing the work with constructing a Model Convention for avoiding double taxation (Appendix 2, 2014 [interview]). The aim of this work was to establish a Model Convention which resolved the faults of earlier attempts to create Model Conventions. While the Fiscal Committee were conducting their study, the OEEC became the OECD, and in 1963 they delivered a final report of their work entitled “Draft Double Taxation Convention on Income and Capital” (OECD, 2012: 8). This was the first draft of a Model Convention published by the OECD, and the start of the organisation's work with finding effective solutions to solve double taxation. The idea was that this draft would be updated at a later stage when states had some experience in using the Draft Convention in negotiations, and the first revision came in 1971 as the “Model Convention and Commentaries” (OECD, 2012: 8). As economic conditions changed internationally, fiscal relations increased, new complex business organisations emerged at the international level and new technologies were developed, the OECD realised in 1991 that the revision of the Model Tax Convention had become an ongoing process (OECD, 2012: 8-9). The Model Tax Convention is therefore today an ambulatory Convention which is updated periodically and which has included states outside of the OECD in the process of updating the Convention. The latest update was completed in 2010, and the full version of the document was published

in 2012. This latest update and publication is used extensively in this thesis, and when I cite OECD, 2012 it is the updates from 2010 which is referred to.

1.3 Background for Research Questions

This thesis will attempt to answer two separate, but closely related research questions. The questions have been formulated after reading about the Model Tax Convention and developing a curiosity over how the Model Tax Convention has become an important tool internationally. This is particularly curious because the OECD is an organisation with 34 member countries, but aiming to promote policies around the world. How an organisation has gained influence so far beyond the scope of its membership is interesting considering the development of international relations the last decades with ever-increasing interdependence between states with regards particularly, but not exclusively, to economic integration in the global economy.

As globalisation is increasing the scope of the global economy the issue of how development is to occur is debated to great lengths within international relations. There is a vast difference between the economic situation in developed and developing countries. Economic integration has been put forwards as a solution to end poverty. For instance, the political scientist John Glenn has proposed debt relief for developing countries through the Highly Indebted Poor Countries (HIPC) Initiative (2007: 206) to promote development. Joseph Stiglitz and Andrew Charlton has suggested that all states should allow for open market access to developing countries which are “poorer and smaller than themselves” (2005: 94). Trade agreements, subsidies and tariffs are other issues which have been negotiated over several years in the Doha Round of the World Trade Organisation (WTO), and which could have the ability to improve the economic situation for the poorest countries in the world if policies are made to their benefit. Simultaneously, developing countries are estimated to lose \$1260 annually due to illegal tax avoidance (Kar and Curcio, 2011). Illegal tax avoidance through tax havens is often associated with criminals and corruption, but 60-65% of lost tax revenue results from commercial activity (Ken and Curio, 2011). Illegal tax avoidance is becoming an increasing concern on the international agenda, with the EU, the OECD, the G8 countries and civil society being the main drivers to find solutions. The increasing focus on taxation matters

should be considered not simply in light of illegal activities, but also in terms of the structural framework for delegating taxation rights. This is where the Model Tax Convention is of particular importance. Using the Model Tax Convention as a tool for negotiating taxation treaties between states is a step towards creating systems of taxation beyond the scope of the domestic economy in order to adapt to the globalisation of the political economy.

The systems of taxation in existence today are governed by national authorities. Determining taxation rates and systems is considered an internal matter for individual states. At the same time some unity is required to deal with transnational transactions. Double taxation, as we have seen, is considered to be an obstacle for foreign direct investments (FDI) and trade. In order to promote economic activity across borders, the Model Tax Convention is constructed as a tool for negotiating taxation treaties between states. However, these two levels of governance should be kept in mind when considering the negotiations between states over bilateral taxation treaties. Negotiators cannot change national taxation systems, but have to form a consensus which is in line with systems and expectations.

This thesis will deal with one area of taxation in particular, namely the taxation of royalties. Before the research questions are presented, I would like to outline where royalties derive from and why taxing royalties is an issue of particular importance.

The Model Tax Convention defines royalties as follows: “The term “royalties” as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience” (OECD, 2012: 30). A royalty then, is a payment for the right to use property or knowledge that belongs to someone else. A good example is if an artist makes and records a song which is sold on iTunes. For every download, Apple as the owner of iTunes will have to pay a royalty to the artist. Through this mechanism, the artist can potentially earn money 50 years after the song was recorded even if no CDs are sold. However, the income the artist receives is not considered business income or income from employment, but income from royalty payments and is therefore taxed according to different taxation laws. In most states the taxation rates on royalties is roughly the same as corporate taxation rates. The Model Tax Convention has constructed policies for

where income from employment, business, dividends, shipping, capital gains and so on, should be taxable. For the most part, the Convention follows policies which make for a distribution of national income from taxation, where taxes are shared between the two states in question according to criteria of where income is generated. However, when it comes to the taxation of income from royalties, taxation rights are rewarded exclusively to the state of residence (usually high income countries). That means that source states (usually low income countries) should reduce their taxation rates on royalties with a source in their country to zero. In the case of the artist used above, this would mean that if the artist registered his song in one country, the royalties would be taxed here even if he recorded and released the song in another state. This principle of exclusivity is widely debated, and as we shall see in later chapters, contested by developing countries.

In addition to taxation of royalties being of a different nature in the Model Tax Convention due to the exclusivity principle, the issue is of particular interest for other reasons related to international trends. First, the value of royalty payments have grown significantly over the last forty years due to an increasing reliance on outsourcing, the upsurge in the use of computers and software, and due to the increasing ease with which intangible property can be relocated anywhere in the world (Brooks, 2007: 178). These factors together means that royalties are worth more and are more frequently used. Secondly it has become easier to classify a payment as a royalty (Brooks, 2007: 178). In the case of the artist, the sale of CDs would have been classified as business income, but as more and more properties are digitalised, it becomes easier to classify payments as royalties. The same is true for the sale of books which has traditionally been characterised as business income, while eBooks fall under the category of income from royalties. In this case, the sale of an eBook would be taxed in the state of residence, even though the digitalisation of the book was most likely done in the source state. These trends makes the taxation of income from royalties more important, as the amount and value of royalties are increasing and royalties account for a larger share of capital to be taxed exclusively in the state of residence. It is not due to some strong sense of justice or developmental concerns that this thesis is focused on the issue of royalty taxation, but this background goes to show that the issue is controversial and of particular interest as it diverts from other propositions in the Model Tax Convention. As will be uncovered in greater detail in Chapter 4 and other empirical chapters, the principle of exclusive taxation rights to the state of residence has been received with scepticism by developing countries in particular.

It should be noted that where royalties are taxed is an issue which has large implications for the income for states. The potential income that states stand to gain or lose based upon the propositions of taxation treaties is enormous. Coupled with the international trends described above, it should be clear that the topic of royalty taxation is of considerable economic and political significance.

1.4 Research Questions

With this historical and empirical background the following research questions have been formulated:

“How has the OECD proceeded in legitimating the Model Tax Convention? Why do countries from all over the world adhere to the OECD Model Tax Convention and its principle of exclusive right to tax royalties in states of residence?”

The two questions are separate in the sense that they address different actors, but they are intrinsically linked by the fact that the answers will help shed light on the international standing of the Model Tax Convention, both how it is perceived and how it is used.

Through answering the research questions I wish to contribute to several theoretical and empirical debates within political science. First, the question of adherence is becoming increasingly more important within studies of international politics. As will be outlined in further detail in Chapter 2, the question of what makes states comply with international norms and standards, is an ongoing debate. This thesis will contribute to the debate in the sense that it will explore reasons for adherence linked to an understanding of legitimacy and voluntary adherence. In other words, the thesis will not explore the reasons for adherence linked to the enforcement school or the management school, but will instead focus on variables of legitimacy, self-interests and power in negotiations, which will be further elaborated upon below.

Second, I wish to contribute to empirical debates around taxation in particular, and the role of institutions in general. This thesis will deepen the understanding of the Model Tax Convention and the OECD's work on taxation. By analysing the Model Tax Convention from both the perspective of the legitimization strategies of the OECD, as well as from a more practical perspective of state's level of adherence and reasons for adherence, this thesis will provide new empirical evidence on the influence and importance of the Model Tax Convention. Furthermore, the issue of taxation can be considered part of the ongoing debate on distributive politics. Institutions are considered tools for the distribution of resources, and in this sense the OECD contribute to the debate over how income from taxation should be divided among states.

1.5 Outline of Thesis

The research questions will be answered through three empirical chapters. Before I start the analysis, the next chapter will outline the theoretical background upon which this thesis is based. The overarching theories of liberal institutionalism, realism and constructivism will briefly be accounted for, as variables developed draws upon aspects of all these major theories of international relations. The majority of the theoretical discussion will be focused on the theories of legitimation and legitimacy as presented particularly by Marc C. Suchman, but mentions of Allen Buchanan and Robert O. Keohane will also be used to account for the legitimacy debate, and theories of negotiation power and self-interests. Chapter 2 will also present the analytical model for how I intend to answer the research questions. Chapter 3 will build upon this model and outline the methods to be used. I will use the method of congruence in the analysis as well as an expert interview. The chapter will also assess the research design of the thesis in terms of Gerring's criteria for good research.

The empirical analysis is divided into three chapters. Chapter 4 will focus on answering the research question of how the OECD has legitimated the Model Tax Convention. Using the legitimization strategies based upon the categories of legitimacy presented by Suchman I will use the publication of the Model Tax Convention to conduct a theory-guided analysis of the strategies used by the OECD. Chapters 5 and 6 will turn to answering the second research question of why states adhere to the Model Tax Convention. The focus on actors will shift

from the OECD to states in these chapters. Both chapters will first focus on determining to which extent states in fact do adhere to the Model Tax Convention and the principle of exclusive rights to tax royalties in the state of residence. Chapter 5 will consider the reservations that states have the opportunity to make and determine the reasons for adherence. Chapter 6 will look at a sample of bilateral taxation treaties in order to gain a better understanding of how the Model Tax Convention is used, and to see which factors determine the outcome of negotiations over the content of taxation treaties. Together the empirical chapters will answer the research questions and provide a thorough analysis of the Model Tax Convention, its perception among states and its practical application. Chapter 7 will consider the findings of this thesis as a whole and identify possibilities for further research.

2 Theoretical Background and Analytical Model

2.1 Introduction

Theory has been defined as “some simplifying device that allows you to decide which facts matter and which do not” (Baylis and Smith, 2005: 3). In order to study phenomena in international politics it is necessary to use such a device in order to sort out the facts that are of interest to one's study. The alternative would be to consider all the possible myriad of facts in existence which is simply impossible. The study of international relations can be understood as a continuous competition between the theoretical perspectives of realism, liberalism and constructivism, as well as the radical theories (Walt, 1998: 30). Each school of thought has overarching views on how the world works, as well as different branches of scholars who differ on the specific dynamics within the theoretical schools. Realism has been the dominant theory throughout the Cold War, and aims to study the facts of the world without notions of how these facts could or should change (Baylis and Smith, 2005: 4). Some scholars, such as Buzan, categorise the remaining theories of international relations into what he calls idealism and states that these theories attempt to study how the world ought to be, and to identify ways to avoid wars and conflict internationally (Buzan, 1996: 47, Baylis and Smith, 2005: 4). This distinction is however too broad in the sense that it does not capture the subtle differences between liberalism, constructivism and radical theories of Marxism. One should bear in mind the existence of several theoretical perspectives when studying international relations. This chapter will in section 2.5 outline the major theories of realism, liberal institutionalism and constructivism to serve as the overarching theories from which variables will be developed.

This chapter will outline the theoretical framework for my research project, and indicate how I intend to use different theoretical contributions by introducing the analytical model. I will start by outlining the theoretical framework for legitimacy and legitimation strategies. The

theories outlined here will be used to identify variables of legitimation to answer the first research question of how the OECD has legitimated the Model Tax Convention. Section 2.4 will briefly indicate the theoretical reasons for why adherence is an important and interesting topic to study in current international relations. Section 2.5 will address the theoretical perspectives used to derive explanations for adherence, where theories of legitimacy will be briefly returned to, as well as theories of self-interest and power in negotiations. After the theories have been outlined I will in section 2.6 develop the variables used to answer the second research question and construct the causal model. The purpose of this chapter is thus to present the theoretical background and framework that the rest of this thesis will build upon, and serve as a building bridge between theory and the empirical research and analysis in later chapters.

2.2 Legitimacy and Legitimation

This section will present the theoretical framework needed to answer the first research question of how the OECD has proceeded in legitimating the Model Tax Convention, as well as the theoretical background on legitimacy which is to be partly used to answer the second research question. This section will start by giving a general introduction to theories of legitimacy, before it turns to legitimation and develops variables to answer the first research question. The difference between legitimacy and legitimation should be made clear.

Legitimacy refers to the audience's perception of an organisation and its policies. Legitimacy is thus the end-point that organisations seek to achieve. In answering the research question of why countries adhere to the Model Tax Convention of the OECD, the explanation may lie in the fact that they perceive the organisation as legitimate. In order to achieve legitimacy, organisations go through a process of legitimation. In answering the research question of how the OECD has gone about in legitimating the Model Tax Convention, it is the process of legitimation which is of interest.

The theoretical landscape concerning institutional legitimacy is varied and spans from political science, sociology, and law, to organisational studies and business management. The extensive interest in the topic from authors from multiple academic fields reflects the importance of understanding the motivations behind institutions and organisations. Since the

late 1960s a change in how scholars view organisations has become apparent. Rather than focusing on the technological and material imperatives of organisations, cultural aspects, symbols and beliefs have come to define the dynamics of organisations (Suchman, 1995: 571). This transformation of the organisational debate has its grounding in the concept of institutional legitimacy. Understanding how an organisation has come to enjoy the legitimacy of an audience can help shed light on the internal and external dynamics of the organisation. Arriving at an understanding of institutional legitimation is thus of interest to scholars from the above-mentioned academic fields and beyond.

At the core of the discussion is the Weberian notion of legitimacy as a “conscious acceptance of certain behaviours and beliefs by social actors” (Drori and Honig, 2013: 347). Although this is a fairly vague definition of institutional legitimacy, it is in many ways the origin of the modern legitimacy debate, and is reflected in the literature. The definition identifies that social actors are the key audience for recognising an institution as legitimate, and the standard for determining legitimacy is a common understanding amongst this audience. The Weberian tradition also states that legitimacy provides the 'right to govern' (Courpasson, 2000). The right to govern is thus the end-point that institutions should attempt to reach, through a process of legitimation. While Bodansky (1999: 599) defines democracy as the most important basis for legitimacy in international politics, this thesis seeks to go further into the legitimacy debate and understand the processes that lie behind the legitimacy of an organisation.

In order to do so, I have chosen to base this research project mainly upon the contribution from Marc C. Suchman who in 1995 published the paper “Managing Legitimacy: Strategic and Institutional Approaches”. In this paper he synthesises the existing literature on organisational legitimacy, and develops a broad definition of the concept. He also identifies a typology, where three main types of legitimacy are outlined. These are pragmatic legitimacy which refers to actor's self-interests, moral legitimacy which is a more normative approach, and cognitive legitimacy which refers to organisations gaining status to the point where it is taken for granted. In addition, he examines strategies for how an organisation can gain, maintain and repair their legitimacy with respect to each of these categories. This paper is

central within scholarly work on legitimacy and is often used by authors who apply theories of legitimacy and legitimation in their research.

There is a variety of different types of scientific texts which use Suchman's seminal 1995 paper as theoretical background (ISI Web of Science). Through looking up citations in Web of Science, I find that the piece has been cited more than 1500 times in academic texts. Suchman defines legitimacy as “a generalised perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions” (1995: 574). This definition is re-cited by several scholars when applying the concept of legitimacy in their work. As Suchman notes (1995: 572), many scholars employ the term legitimacy, but few define it properly. This observation has been accepted by several scholars, and many strive towards defining the term, often by using Suchman's definition (e.g. Hurd, 1999; Suddaby and Greenwood, 2005; Tyler, 2006; Zimmerman and Zeitz, 2002). Philips, Lawrence and Hardy (2004) use Suchman's recognition that actors use strategies for gaining, maintaining and repairing legitimacy in their discourse analysis of the underlying processes of institutionalisation. Zimmerman and Zeitz refer to Suchman when they develop their theory on how new ventures gain legitimacy, by building on Suchman's strategies of conforming, selecting and manipulating environments in order to gain legitimacy (2002: 422). Tyler (2006) use Suchman's work in a psychological analysis of how authorities benefit from being viewed as legitimate by the people they are to lead, and Suddaby and Greenwood (2005) use the notion of pragmatic, moral and cognitive legitimacy when they analyse the role of rhetoric in legitimating institutional change. These papers show how Suchman's work has influenced scholars far beyond his own field of organisational studies and into the fields of psychology and administrative science. Political scientists have also used Suchman's work. Ian Hurd examines what makes states follow international norms, rules and commitments and expands on classical international relations explanations of coercion and self-interest, to include legitimacy as an explanation for state's behaviour in the international system (Hurd, 1999: 379-380). Other scholars such as Kostova and Zaheer (1999) and Scott and Lane (2000), refer to Suchman as one of the scholars who have examined legitimacy at the organisational level rather than at the level of classes (Kostova and Zaheer, 1999: 65), and view organisations as objective viewers rather than groups of particular observers (Scott and Lane, 2000: 49). Cashore's contribution from 2002 analyses

non-state, market-driven governance systems in the case of sustainable forestry certification. Although his empirical focus differs from the focus of this paper, he develops his theoretical framework from Suchman's typology of legitimacy, and draws heavily upon his seminal 1995 work (Cashore, 2002: 506), which is similar to the study in this thesis.

As noted, Suchman (1995: 574) defines legitimacy as “a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions”. This definition is inclusive and broad-based, but also explicitly acknowledges that social audiences are central in defining the dynamics of legitimacy, in accordance with the Weberian notion of legitimacy. It also recognises that legitimacy comes from some outside-entity which bestows the organisation with its perception of legitimacy. Suchman (1995) further distinguishes between three primary analytical categories of legitimacy which all fit within the definition above. These are pragmatic, moral and cognitive legitimacy. According to Suchman's typology, pragmatic legitimacy refers to the self-interested calculations of an organisation's most immediate audiences, moral legitimacy entails that the organisation is considered to inherent positive values and practices, and cognitive legitimacy is a less active, but even more robust form of legitimacy where the organisation is seen as the best and only viable option for its purposes. Strategies to promote all types of legitimacy can be employed by organisations.

In Suchman's writings, it becomes evident that he believes that current researchers fail to define legitimacy coherently, and that this often leads them to neglect important parts of the concept of legitimacy. The need for identifying which aspects of legitimacy one is to consider is key according to Suchman (1995: 602), and through this chapter, I hope to give a clear picture of which aspects of legitimacy and legitimation this project is based upon, as well how these will be used in the empirical analysis.

In their article “The Legitimacy of Global Governance Institutions” from 2006, Buchanan and Keohane develop what they call a complex standard of legitimacy. For a thorough review of organisational legitimacy, they refer readers to Suchman's paper from 1995. The standard they

develop rests upon the assumption that institutions must have three institutional attributes in order to be deemed legitimate. These are minimal moral acceptability, comparative benefit, and institutional integrity. Minimal moral acceptability entails that institutions must refrain from committing serious injustices, such as violating human rights (Buchanan and Keohane, 2006: 419). Buchanan and Keohane thus has a less strict definition of the moral standards that an institution has to uphold than Suchman, who defines moral legitimacy as “the right thing to do”, but they also recognise that the standard for legitimacy should allow for, and even encourage institutions to work towards developing more demanding requirements for justice internationally (Buchanan and Keohane, 2006: 421). However, the concept of minimal moral acceptability still seems to correspond to Suchman's moral legitimacy. Both contributions claim that organisations and institutions must live up to a certain standard of morality in which they show their audience that the institution is committed to doing the right thing. Only then will the audience be able to accept the institution as legitimate. Comparative benefit refers to the ability of the institution to provide some benefit to its audience that would not otherwise be obtained (Buchanan and Keohane, 2006: 422). This means that the goals of the institution must be fulfilled, and that the audience that the institution is to address must consider the policies and the actions of the institution as beneficial. That an institution is deemed legitimate based upon the benefits that its audience considers it to have, again seems familiar with regards to Suchman's typology, and the concept is closely related to that of pragmatic legitimacy which is the benefits that an organisation bestows upon its audience. The last aspects of Buchanan and Keohane's complex standard of legitimacy is that of institutional integrity. An institution must show that they do not exhibit a pattern of disparity between its actual performance and its goals and claimed procedures (Buchanan and Keohane, 2006: 422). This aspect of defining and categorising legitimacy differs from Suchman's typology, and Buchanan and Keohane do not include anything which shows similarities with cognitive legitimacy in their complex standard of legitimacy. Institutional integrity, as framed by Buchanan Keohane, will not be used further in this study. If the research question addressed the legitimization of the OECD as a whole rather than the Model Tax Convention, institutional integrity would have been a useful concept to apply, but as the research question is limited to the Model Tax Convention, institutional integrity falls outside the scope of my thesis.

Before moving on to addressing each way of legitimating organisations and institutions, a note must be made of the difference in scope that each theoretical contribution outlined above refers to. While Suchman talks about the legitimacy of organisations, Buchanan and Keohane refer to that of global institutions. The scope of legitimacy is thus very different, as organisations in Suchman's theory are national, while Buchanan and Keohane address global governance institutions in a much more complex environment. The OECD in this thesis falls somewhere in-between these notions of organisations and institutions. OECD stands for The Organisation for Economic Co-operation and Development, but has a broader agenda than Suchman's national organisations. However, not as broad as to be identified as a global governance institution, as membership is limited and is constrained to include only the most advanced economies in the world, as well as a few emerging economies. Suchman's work has been of such importance to the topic of legitimacy, also in the field of international studies that the theory is also relevant in analysing the OECD. I will now turn to the types of legitimacy mentioned above, and show how the OECD may employ these as strategies for legitimisation. The reason for including Buchanan and Keohane in this discussion is to show how the framework presented by Suchman is supported by the writings of Buchanan and Keohane. Their theoretical frameworks differ slightly, but the essence of how the two contributions define and categorise legitimacy is complementary. In addition, Buchanan and Keohane have a more international scope which makes the theory relevant for this study.

Pragmatic legitimacy refers to legitimacy based on the self-interested calculations of an organisation's most immediate audiences (Suchman, 1995: 578). This means that an audience will make this judgement based on their own calculations of what benefits they stand to gain or lose by accepting the organisation.

The most basic form of pragmatic legitimacy is exchange legitimacy, which refers to an audience supporting an organisation in exchange for policies which are expected to be of value to the audience (Suchman, 1995: 578). That is, if the audience expects the sum of the policies of an organisation to be of value, they will perceive it as legitimate. Pragmatic legitimacy can also appear in the form of influence legitimacy, in which an audience deems the organisation legitimate because they believe that the organisation represents their larger interests (Suchman, 1995: 578). By incorporating audiences into the organisation's policy-

making structures, or by adopting the policies and standards of an audience as its own, influence legitimacy can arise. Dispositional legitimacy can also be regarded as a form of pragmatic legitimacy. More dispositional characteristics from the audience, such as a belief that the organisation has “our best interests at heart” or “share our values”, can result in the organisation achieving legitimacy. This last form lies on the boundary between pragmatic legitimacy and moral legitimacy, but the key here is that the dispositional characteristics reflect that the audience holds the belief that these characteristics are beneficial primarily for their own interests.

Pragmatic legitimacy thus has several aspects, but overall pragmatic legitimacy is based upon self-interested evaluations of the organisation as a whole by its audience. An organisation which has a desire to be evaluated as pragmatically legitimate will employ strategies of legitimation in which they emphasise the self-interests that states have in accepting the organisation. We would expect to see statements that focus on why states should accept this particular organisation over alternative actors that pay particular attention to the benefits that states will gain.

Buchanan and Keohane's version of pragmatic legitimacy is what they call comparative benefit. In their view, institutions have primarily an instrumental justification for existing. The main reason why an audience accepts an institution and their activities is because they see the institution as a provider of some benefits that would not otherwise be obtained (Buchanan and Keohane, 2006: 422). Buchanan and Keohane thus have a similar understanding of the first pillar of legitimacy as Suchman, which in this thesis will be referred to as pragmatic legitimacy.

Moral legitimacy is based on positive normative evaluations of the organisation and its activities (Suchman, 1995: 579). Audiences base their judgement of the moral legitimacy of an organisation upon whether its activities are considered “the right thing to do” (Suchman, 1995: 579), which is an evaluation of whether this activity is deemed as efficiently promoting social welfare. This is a normative evaluation as stated at the outset, but nonetheless an evaluation based upon the socially constructed value system of the audience. According to

Buchanan and Keohane (2006: 419), the minimum requirement of a value system is the basic human interest's conception of human rights. The basic human interest's conception is derived from the writings of Joseph Raz and states that rights are normative relations and provide a protection of interests (Raz, 1986:17). Because the notion of human rights is contested amongst scholars as to what the appropriate content of rights should be Buchanan and Keohane claims that only the least contested rights have to be upheld by an institution in order for it to be legitimate (2006: 420). They themselves admit that this is indeed a minimal standard, but I would go further and say that it's a weak standard of morality. Rather, I believe that an audience will have higher moral requirements towards an institution, and would not acknowledge the institution as legitimate unless some greater principles of morality were upheld than simply observing the least controversial human rights. Instead, I believe that Suchman has a more relevant view of morality, even though the definition of morality as "the right thing to do" is more abstract and subjective than Buchanan and Keohane's definition. One reason for the differing standards may be the aforementioned differentiation in scope between Suchman and Buchanan and Keohane. Suchman has a more limited scope when he addresses organisations at the national level, while Buchanan and Keohane examine institutions at the global level, and global norms are weaker as wider spectres of actors have to agree. Regardless, moral legitimacy in this thesis will be defined through Suchman's definition, resting on whether the institution and the audience are concerned mainly with whether policies reflect the "right thing to do". Because moral legitimacy is a normative evaluation, it will by its very nature depend on the subjectivity of the particular member of the audience in question. Moral legitimacy will for the purpose of this project be viewed as pro-social, positive normative judgements from each member of the audience based upon their socially constructed value system. Moral legitimization strategies are conscious efforts from the organisation to appeal to its audience's morality and be accepted as morally legitimate.

Consequential legitimacy is one sub-category of moral legitimacy in which the institution is judged by its accomplishments (Suchman, 1995: 580) and whether these are considered rightful by the audience. Another form of moral legitimacy can derive from procedural legitimacy, which refers to the organisation being perceived as using "sound practices" or generally applying techniques or procedures which are socially accepted. If outcomes are produced in a way which explicitly includes evaluations of moral factors in the production

process, then procedural legitimacy can be achieved. Such a procedural step can be to emphasise democratic or all-inclusive policy-making where actors are involved in influencing the policies that are produced. As this thesis will show, the OECD taking steps towards including non-members states in the process of producing and evaluating policies, can be one such procedural measure. Similarly, structural legitimacy can be achieved if the organisation is perceived as having “sound structures”. If the structural characteristics of an organisation can be identified as having morally favourable outcomes, as reflecting its capacity to perform, this may result in structural legitimacy. Lastly, moral legitimacy can be achieved through personal legitimacy (Suchman, 1995: 581). Having a charismatic leader who is considered to add some moral standing to the organisation may also result in audiences considering the entire organisation as legitimate. In the case of taxation matters in the OECD, personal legitimisation is not expected to be of any significant relevance.

When measuring moral legitimacy and moral legitimisation strategies in this thesis I will focus on whether states and the OECD are arguing in favour of the organisation by using moral, pro-social justifications. If states choose to emphasise normative arguments in favour of the OECD and the Model Tax Convention this may indicate that they adhere based upon these arguments. The OECD may also try to appeal to the morality of states in their legitimisation of the Model Tax Convention.

Cognitive legitimacy is a less active type of legitimacy, where the audience deem the organisation as necessary or inevitable (Suchman, 1995: 582). Cognitive legitimacy does not rest on conscious evaluations in the same manner as pragmatic or moral legitimacy, but rather depends on the audience taking an organisation as a given. This type of legitimacy is harder to achieve, but will also provide the most stable and resilient form of legitimacy if it is achieved (Suchman, 1995: 585). If an organisation's activities are taken for granted, in the sense that other alternatives are unthinkable, it has reached cognitive legitimacy. The organisation can also have activities which are so all-embracing that they are no longer subject to active scrutiny or a myriad of competing alternatives, also referred to as the comprehensibility of the organisation. These two forms of cognitive legitimacy are fairly close to each other, but the difference lies in the level of 'obviousness', where taken-for-grantedness is the most stable

version, and also encompasses the less solid comprehensibility characteristic which is achieved if the activity the organisation provides seems significantly less meaningful without the organisation.

Cognitive legitimacy can in general be recognised by a lack of contemplation by the audience, as calculations and evaluations are absent if they perceive it comprehensible or if they take it for granted. Through a concealing of information and a lack justification of the organisation it is possible to find evidence of cognitive legitimization strategies from the organisation itself.

The theoretical framework of legitimacy and legitimization strategies that has been presented here focuses mainly on Suchman's categories of legitimacy, with Buchanan and Keohane as supportive contributors to the theory. In order to answer the second research question a more comprehensible theoretical framework is necessary, but before I outline the remaining theories, the variables used to answer the first research question will be presented in the next section.

2.3 Variables of Legitimation

The previous section outlined the relevant theories needed to answer the first research question. In order to find out which strategies of legitimization the OECD has used to promote the Model Tax Convention, the following variables will be considered.

Pragmatic legitimization is strategies based upon promoting the self-interests of states. In empirical analysis, pragmatic legitimization can be recognised by the OECD emphasising how the Model Tax Convention is beneficial to states. Alternatively, if the OECD makes an effort to show how their values are in line with their audience's values, this might be a sign of pragmatic legitimization which stresses dispositional attributes.

Moral legitimization strategies by the OECD will be recognised by attempts to communicate how the Model Tax Convention represent the “best thing to do” for countries in international taxation matters. Moral legitimization can be recognised in the empirical data by statements that emphasise the pro-social and more normative aspects of the Model Tax Convention, as well as efforts to be inclusive and fair.

Cognitive legitimization strategies may be recognised by efforts by the OECD to indicate that the Model Tax Convention is, or should be, the obvious choice of a model for negotiating taxation treaties. Through efforts at concealing information or downsides to OECD and the Model Tax Convention cognitive legitimization efforts can be recognised.

This chapter will now turn to the theoretical framework needed to answer the second research question of why states adhere to the Model Tax Convention.

2.4 Adherence

The dependent variable in the second research question which asks why states adhere to the Model Tax Convention is adherence. The word adherence has its origin from the Latin word “adhaerere”, where 'ad' means 'to', and 'haerere' means 'to stick' (Oxford University, 2005). In international politics the literal translation of 'to stick to' policies, organisations or agreements is not often used, but conjugations with the same meaning such as 'adherence', 'abide by', 'comply with', 'respect' or 'follow' are more commonly used to communicate the same phenomena. As topics of international governance are rising on the agenda internationally, the issue of adherence to these governance-efforts has also become central. Within international environmental governance increasing amounts of literature on compliance with international environmental regimes are emerging (see e.g. Barrett and Stavins, 2003 and Hovi, Sprinz and Underdal, 2009). The literature on compliance within international environmental regimes is representable for the general international relations literature which is becoming increasingly occupied with the issue of adherence to international norms, rules and commitments. The most common question asked is why states adhere to the norms, rules and commitments that

are being imposed on them by some outside entity.

One scholar who has addressed the question of why states comply is Ian Hurd, who has a more general focus on international relations than the scholars of environmental regimes, and opens his article from 1999 by asking “*what motivates states to follow international norms, rules, and commitments?*” (Hurd, 1999: 379). Although Hurd focuses on enforcement of these international norms, rules and commitments, this article represents one example of how compliance and adherence has become an important issue on the international agenda.

With the theoretical background of adherence outlined, it is possible to explore how this thesis will use adherence as the dependent variable. The variable will measure to what extent states in fact adhere to the Model Tax Convention and will be treated as a scaled variable. High adherence implies that a state accepts the content of the OECD Model Tax Convention, while low adherence implies that a state is less accepting of the propositions of the OECD. In some cases non-adherence may be referred to, which means that a state does not accept a particular proposition of the Model Tax Convention. However, non-adherence to a proposition does not necessarily mean that a state disregards the Model Tax Convention as a whole, but rather that a state's adherence is lower on the scale. As this thesis will focus on the OECD principle of exclusive taxation rights to the state of residence on income from royalty payments, low adherence on the dependent variable may not be a sign of low adherence to the entire Model Tax Convention. However, the issue of royalty taxation has several commonalities with the remaining propositions of the Model Tax Convention. In general, the OECD favours taxation in the country of residence, and promotes tax exemptions in the source country which is also the case with royalty taxation. Royalty taxation is a particularly controversial issue-area and one that has been debated to great lengths due to OECD's principle of *exclusivity* to the state of residence. It is because of the special importance of the exclusivity principle that I have chosen to focus my analysis on royalty taxation, which may also allow for a limited generalisation to the remaining propositions of the Model Tax Convention.

Adherence will be measured in different ways depending on the empirical data at hand. In Chapter 5 adherence will be measured by looking at whether or not a state has reserved itself

from the OECD propositions. Through the process that the OECD has initiated to evaluate and continue to develop the Model Tax Convention, it is possible to disagree with certain propositions of the Model Tax Convention, and show this through reservations. A reservation can be interpreted as an intention not to adhere to this proposition of the Model Tax Convention, while a lack of a reservation can be interpreted as an intention to adhere. The first level of measuring adherence is thus through these reservations.

I will measure adherence also by looking at bilateral taxation treaties in Chapter 6. Analysing a strategic sample of taxation treaties which have been concluded between states allows a consideration of how states act upon the reservations they themselves have made, or that the other contracting party has made. The sample is chosen based upon the variables considered to be important for explaining variance. If reservations are respected, then adherence to the Model Tax Convention is lower as propositions are followed to a lesser degree.

In order to explain adherence, independent variables will be identified based upon the theories of realism, liberal institutionalism and constructivism. The next section will give an introduction to these general theories before it goes on to outline the more specific theories to be used to identify the independent variables.

2.5 Approaches to Explaining Adherence

Realism has thus far been described as a theory aimed towards seeing the world as it is, rather than how it should be. But realist theory has more to it than simply a desire to study the facts of the world. The realist tradition has a long lineage and early notions of realist theories can be dated back to Thucydides, Machiavelli, Hobbes and Rousseau. These scholars described the anarchical nature of international politics and focused on the human nature outside the organised polis of the state. Anarchy in realism is defined as a lack of a central authority to control the actions of sovereign states (Dunne and Schmidt, 2005: 163).

The inter-war period experienced a new surge in realist thinking and during the Great Debate of the late 1930s and early 1940s scholars such as Carr, Morgenthau, Niebuhr and Kennan took to the stage (Dunne and Schmidt, 2005: 162). During the Great Debate realism took a more academic form, and one of the central teachings was that leaders should focus on interests rather than ideology and that peace could be obtained through the strength of nations (Dunne and Schmidt, 2005: 162). The outbreak of World War II ended the Great Debate, and realist scholars considered the war empiric evidence for the triumph of realism. After the Second World War more modern scholars became important within realist theoretical debates such as Waltz and Mearsheimer who can be described as neorealist, or more specifically structural realists (see Waltz 1979, Waltz 1991, Mearsheimer 2001). Neorealists claimed to be more scientific than its classical predecessors, and wanted to operationalise the foundations of realism by narrowing them down to the element of structure (Forde, 1995:142). The distribution of power in international politics was the most important explanatory factor for why states behave as they do according to structural realism. But structural realism has also been challenged, most notably for the parsimonious assumption of distribution of power as the single most important explanatory factor in international politics. Contemporary realists such as Walt and Schweller have been characterised as neoclassical realists by Gideon Rose (1998), and they attempt to build a bridge between classical and structural realists by incorporating factors such as the perception of state leaders, state-society relationships and the motivation of states into the theory of realism (Dunne and Schmidt, 2005: 170). What they try to do then is to “place [...] domestic politics as an intervening variable between the distribution of power and foreign policy behaviour” (Walt, 2002: 211).

What this review of the history of realism shows us, is that one cannot speak of a single theory of realism on which there is consensus. Realism is fragmented and different approaches as to how one can measure realism exist in the literature. However, there are certain important similarities which are the core elements of realist theory. The most important aspect of realism is the assumption that interactions between states find place in an anarchical state of affairs. Anarchy is the lack of a central authority to control the actions of sovereign states (Dunne and Schmidt, 2005: 163). Furthermore, realists agree upon the three Ss of realism, namely statism, survival and self-help (Dunne and Schmidt, 2005: 172-176). Statism refers to the state being the main actor, and the only sovereign entity in international

politics. Because states are sovereign actors, they compete with each other for security, markets and influence – in short they compete for power. The ultimate goal of the sovereign state is that of its survival. Secretary of State under the US presidency of Nixon, Henry Kissinger put the issue of survival into words: “a nation's survival is its first and ultimate responsibility; it cannot be compromised or put to risk” (Kissinger, 1977: 204). Because of the anarchical state of nature in the international system and the lack of a higher authority, security for states can be achieved only through self-help (Dunne and Schmidt, 2005: 175). Self-help is “necessarily the principle of action” according to structural realist Waltz (1979: 111). Rousseau's parable of the stag hunt where one hunter will sacrifice the interests of the group in order to satisfy his own immediate interests is a traditional illustration of the phenomena of self-help (Skyrms, 2004: 1). The core element of self- help in realism provides the basis for self-interests as a key priority of states, which will be elaborated upon below. With regards to self-interests it should be noted that as opposed to liberalism, realism assumes that states are positional, which means that they are not only concerned with their absolute gains, but also their relative gains (Grieco, 1988: 487). Being concerned with relative gains means that states in collaboration with other states and actors will not simply accept outcomes which increase their gains in absolute terms, but they will be hesitant to accept solutions which increase their gains less than their opposing party in negotiations or other collaborations. States will seek to maximise their gains and benefits to balance their power and self-interests against their opposing party.

Liberalism has been the theory which has contested realism the most in international relations. While constructivism has been on the rise since the early 1980s with its emphasis on ideas, knowledge, norms and rules (Barnett, 2005: 252), and radical theories with Marxist thought about the nature of the capitalist market are still relevant – maybe even increasing in importance (Hobden and Wyn Jones, 2005: 226), liberalism has been the challenger to realism in the academic field of international relations with the longest history. Liberalism can be traced back to the writings of John Locke in the late seventeenth century, but had its surge in the inter-war period when it was believed by many that war was an outdated way to settle disputes between states (Dunne, 2005: 188). Liberal thought argues that economic interdependence will increase cooperation and discourage war and conflict between states, because the use of force will threaten prosperity (Walt, 1998: 32). The two most important

aspects of liberalism are the belief that normative thinking is necessary in order to promote peace between states, and that the notion of international cooperation through institutions as a way to secure international stability (Dunne, 2005: 195). Liberalists thus believe that cooperation between states is both possible and desirable, and that institutions can help facilitate these interactions as they provide an arena with rules and norms for states to act within. Liberalists consider absolute gains to be sufficient motivation for states to cooperate, because unlike realists they do not consider relative losses to be existentially threatening (Grieco, 1988: 487). Institutions are thus seen to provide an arena where states can have stable expectations internationally and create mutually beneficial outcomes (Lipson, 1984: 1-2 and 12). Furthermore, institutions can help overcome selfish behaviour from states (Walt, 1998: 32), in the sense that individual short-term gains are foregone on behalf of long-term benefits achieved due to sustained cooperation.

Liberalism thus contributes to the theoretical landscape of international relations by exploring the conditions for cooperation between states. Liberal institutionalism adds to this perspective by encouraging international institutions as an arena to facilitate cooperation and create mutually beneficial outcomes between states.

Constructivism has its origins in the early 1980s and is thus a much newer addition to the theoretical landscape of international relations studies than realism and liberalism. The theory was born out of the dissatisfaction with realism and liberalism, because these more traditional theories of international relations failed to recognise the importance of ideational forces such as ideas, knowledge, norms and rules (Barnett, 2005: 252). Constructivists felt that other theoretical approaches focused too heavily upon states having fixed interests, and upon material forces (Barnett, 2005: 252). One of the most important challenges to realism and liberalism came from Ruggie in 1983 when he challenged Waltz's seminal Theory of International Politics on the concept of change being a force initiated from states. Ruggie argued that the focus that realists and liberalists put on states as being the driver for change and transformation in international politics was failing to take into account important factors such as the density of interactions between actors other than the state (Barnett, 2005: 254). Another influential scholar who gave rise to constructivism was Ashley who pointed to the non-state actors of the world and claimed that realism as a theory did not manage to

understand how states' interests are not fixed, but are rather shaped by the global-historical forces (Barnett, 2005: 254) (Ashley, 1984). Wendt (1987), Onuf (1989) and Katzenstein (1996) are other influential scholars who added to the substance of the constructivist theoretical landscape which developed into a more academic field by the end of the 1980s.

Constructivism's largest input to international relations theory is the added focus on human consciousness and ideas as a structural factor. As a social theory, constructivism addresses the conceptualisation of the relationship between actors and structures (Barnett, 2005: 258). Ruggie (1998: 856) has described constructivism as being concerned with "human consciousness and its role in international life". This consciousness is not given, but is shaped by ideas, knowledge, symbols, languages and rules. These ideas shape how people and states behave, and determine what is deemed legitimate in any given society. The ideas that society is built upon and which has been agreed upon through human interactions construct a reality which is presented to us, and which other theories of international relations have taken as a given. Constructivism thus shows us that the structures in international relations are not coincidental, but have come to be through human nurture. The claim that world politics is socially constructed opposes the materialism that realism and liberalism is built upon (Wendt, 1995: 71).

How states view the arrangements of international politics is therefore not accidental, but has required consideration of social facts. Realities and actions are not random, but "action is driven by an actor's calculation of how a particular strategy is likely to further her preferences (...) They determine their course of action depending on a sense of self and what is appropriate for the situation" (Barnett, 2005: 259).

These three overarching theories of international politics form the basis for the more specific theories that this section now will turn to.

2.5.1 Legitimacy

The theoretical framework for legitimacy was outlined in detail in section 2.2, and a discussion of the theory therefore not necessary here. The perspectives of moral and cognitive legitimacy will be used to analyse whether states adhere to the Model Tax Convention due to a perception of legitimacy, while the perspective of pragmatic legitimacy is considered to fall under the theoretical framework of self-interests as presented in the next section.

2.5.2 Self-interest

Both the theory of realism and liberalism assume that states are occupied with their own self-interests. Pragmatic legitimacy is based upon the self-interested calculations of states.

According to Walt (1998: 38) the main instruments of states are economic and military power. The economic aspect is of the highest interest for this thesis. Economic power can be measured through the economic capabilities of states. As states seek to increase their power, increasing economic capabilities is the main self-interest that states have. Thus, the self-interest of states is to pursue the policy which will maximise their economic capabilities to the largest extent.

Pragmatic legitimacy corresponds to the more realist notion of states pursuing their self-interests. Suchman and Buchanan and Keohane do not explicitly assume that states are necessarily benefit-maximisers, but when conducting evaluations of the pragmatic legitimacy of institutions, states will consider the same rationale as the benefit-seeking realist theory assumes. The implication is that whether states are in fact mainly concerned with their own interests as realists assume or not, calculations of the pragmatic legitimacy of institutions will involve states acting in accordance with the realist assumption.

2.5.3 Power in Negotiations

While outlining the element of statism in realism, it became clear that the power of states is important to the theory. The importance of the state as the key actor in international politics coupled with its main goal of survival, implicates that states need to accumulate power to perform its tasks. Power is a common explanatory factor in analysis of international relations particularly within realism, and will also serve as a potential explanation for the actions of states with regards to why states follow the Model Tax Convention. In this thesis I am mainly concerned with power as a relational concept. This means that the power of one state is of interest only when it is seen in relation to the power of another state.

The issue of relational power is furthermore of interest to this study mainly with regards to the negotiation of bilateral taxation treaties. States meeting with the goal of arriving at a common agreement upon how taxation matters between the two states are to be treated is an arena where the power of each state may influence the outcome. Theories on power in negotiations will therefore be the focus of this section.

Traditional bargaining models in negotiation theories have been based upon game-theoretic models where the actors are assumed to be rational in the sense that they will accept outcomes of negotiation which leave them better off than they were before negotiations took place (Hopmann, 1996: 72). In addition actors are assumed to have more or less the same interests and symmetrical power capabilities, they are assumed to be unitary actors and negotiations are assumed to take place in a vacuum rather than within a system of complexity and interdependence (Hopmann, 1996: 96). However, as bargaining models have been further developed, assumptions have been relaxed and the issue of power distribution has become more central in theoretical as well as in analytical terms. Scholars such as Hopmann (1996), Zartman and Rubin (2000), Habeeb (1988) and Dupont (1994) have contemplated the effect of power on negotiation dynamics and outcomes. The concept of power has been extended beyond the traditional realist perspective of military power and put into the context of negotiations, where not only material capabilities are essential, but also the power of influence through negotiation tactics such as the use of threats or promises.

Hopmann (1996) is one of the main scholars who has described and developed a traditional bargaining model for international negotiations with game-theoretic arguments as the foundation. Such bargaining models assume the rationality of actors, and approximately symmetrical interests and powers (Hopmann, 1996: 96). However, in reality, the utilities of each party, and their power capabilities, are unlikely to be symmetrical. As Hopmann develops the bargaining model for negotiations, he relaxes the assumptions about symmetry and power, and refer to power as the resources that each party to a negotiation hold as well as their ability to exert influence on the opposing party in the negotiations (Hopmann, 1996: 101). The conclusion which is reached from the discussion of this relaxation is that differences in power capabilities between the negotiating parties are important mainly because it translates into a difference in the ability to exert influence on one another in the negotiation setting (Hopmann, 1996: 109). The most important aspect of power relations in negotiations is therefore the balance of power between the parties, as one party may have an advantage over the other party in the case where it holds a greater power to influence this other party. This perspective is important for my study of taxation treaties because these treaties are negotiated between parties with differentiated power capabilities along the relevant dimensions which may influence the outcome of negotiations with regards to preferences about the content and to which extent states should adhere to the Model Tax Convention.

Habeb also recognises that analysis of negotiations have failed to put sufficient emphasis on power, and recommends that this issue should be discussed further to analyse and explain the outcome of negotiations (1988: 10). He develops a framework for power in negotiations which is recognised by viewing power as a process rather than some static concept, a result of having certain resources, and as something which creates outcomes (1988: 14). Power in Habeb's model is a mixture of structural power which refers to the resources of the parties involved in negotiations, and behavioural power which is the ability to use these resources to achieve outcomes (1988: 16 & 23). Structural aggregate power is the sum of the demographic, economic and military resources of a state compared to the external world as a whole (1988: 17), while issue-specific structural power are these resources in comparison with another actor in terms of a specific mutual issue (1988: 19). Behavioural power is reflected by the tactic an actor employs in negotiations, revealed through the communication with the opposing party to the negotiations (1988: 23). Through examining these capabilities and

abilities one can hope to say something about which party to the negotiations may have the greatest ability to influence the other.

Issue-specific structural power can be measured by examining the total sum of material capabilities of a given state with emphasis on the resources relevant for the issue in question. Military, demographic and economic resources can be measured by volume and compared to those of the opposing party to the negotiations. Issue-specific power is considered to be the relevant aspect of power in negotiations with regards to taxation treaties, and only economic capabilities will be measured, because capabilities linked to the military standing of a state is considered far less important for issues of taxation.

2.6 Variables and the Causal Model

This thesis asks two separate, but intrinsically linked questions to be answered. The first question addresses how the OECD has proceeded in legitimating the Model Tax Convention, and the theoretical background as well as the relevant variables were identified in section 2.2. The second research question asks why countries adhere to this Model Tax Convention. This section will present the relevant variables to answer the second question and show how these will be used to construct the argument in this thesis.

Moral legitimacy has been defined as conclusions of what the “right thing to do” is, based upon positive normative evaluations of what efficiently promotes social welfare. Moral legitimacy will be an independent variable in analysing why states adhere to the Model Tax Convention. Moral legitimacy is based upon evaluations about whether the Model Tax Convention reflects prosocial, morally sound propositions. If the OECD is perceived as morally legitimate by states, the Model Tax Convention is more likely to be adhered to than if it is perceived as being morally biased or flawed.

Cognitive legitimacy is less dependent upon conscious calculations and evaluations, and is a conception of legitimacy without rational deliberations. The concept will also be used as a

variable to analyse why states adhere to the Model Tax Convention. If the OECD's policies are taken for granted or perceived as so comprehensive that alternatives are not contemplated, then it can be said to have obtained cognitive legitimacy. It is therefore less obvious signs which may reveal cognitive legitimacy. Statements or actions which signal that no calculations or evaluations have been conducted in order to judge the OECD and the content of the Model Tax Convention may be signs of cognitive legitimacy.

Self-interests is a variable based upon the realist and liberalist assumption that states act to maximise their own interests. In addition to the realist view of states acting to increase their own benefit, pragmatic legitimacy is also calculations of the benefit that states obtain. This is because pragmatic legitimacy is based upon calculations of states' own gains from policies, which corresponds to the realist view. According to both perspectives states will choose to adhere to policies which are beneficial to themselves, and will not adhere to policies which they consider not to be of benefit. In this thesis, self-interests will be used to analyse why countries make reservations to the Model Tax Convention. In this context self-interests will be measured by looking at the level of human development and whether a country is capital-exporting or capital-importing. These measurements are considered to reflect important aspects of states' interests.

Negotiation strength is a variable which focuses on the capabilities to negotiate that each country possesses. Power in negotiations may influence the direction of negotiations, and thus also the level of adherence to the Model Tax Convention. The theoretical background presented by Hopmann and Habeeb identified aggregate structural power, issue-specific structural power and behavioural power as indicators of how power capabilities may be measured. Aggregate structural power is not considered to be relevant in the case of taxation matters. As negotiations over taxation are not expected to be of such crucial interest to any state that its whole system of capabilities are likely to be mobilised, only the issue-specific dimension of structural power is viewed as being of importance. Furthermore, within the framework of issue-specific structural power, military capabilities will not be considered, as taxation issues are generally not associated with military intervention or conflict. Rather, economic capabilities are interpreted as being of the highest importance for the course of negotiations, as taxation issues are located within the sphere of economic relations between two states. The measurement of structural power capabilities will in this thesis therefore be

the volume of each state's economy, where GDP will be used as the indicator. GDP is a measurement which reflects the size of the economy of each state. In negotiations over taxation treaties this is an important measurement as the economic relationship between the two states negotiating is expected to influence the outcome according to realist theories. In taxation matters, the economic aspect is considered to be the most influential part of negotiation power and will be the focus and the way of measuring negotiation power.

A summary of the variables for answering the second research question can be seen in table 2.1.

Dependent Variable	Independent Variables
Adherence to the Model Tax Convention	Moral Legitimacy
	Cognitive Legitimacy
	Self-interests
	Negotiation Power

Table 2.1: Variables

To explain variance in adherence, the theoretical framework developed will be used extensively. The theoretical concepts provide a broad spectrum of explanatory potential for the level of adherence to the Model Tax Convention and the principle of exclusive taxation rights to the state of residence for income derived from royalties. It should be noted that other factors than the ones outlined here may also be relevant in explaining the variance in adherence, but my model includes the most important factors. It is not expected that any of the empirical material analysed in later chapters will provide evidence where it is possible to say with certainty that only one of the independent variables can fully explain all the variance in adherence observed. It is likely that adherence is explained by a mixture of the factors, but where one may be dominant. In empirical chapters each relevant independent variable will

therefore be considered as having the potential to explain variance in adherence, to a lesser or larger degree.

Following the definition of a causal relationship as described by Gerring (2005: 169) the independent variables are the cause of the dependent variable if (and only if) they raise the probability of the dependent variable. In this thesis, that means that different types of legitimacy, self-interests or negotiation power cause the level of adherence if (and only if) their existence raise the probability of higher adherence to the Model Tax Convention.

2.7 Summary

This chapter has presented selected theoretical contributions which will function as the theoretical background for this paper. I started by outlining the theories of legitimacy and legitimation which will be used as factors of explanation to answer both research questions. I have used Suchman's typology of organisational legitimacy to outline the framework for legitimacy and legitimation strategies, with Buchanan and Keohane's complex standard of legitimacy as a supporting theory. The variables which will be used to analyse the legitimation strategies of the OECD were presented to show how the first research question will be answered. The chapter went on to define adherence in theoretical and conceptual terms. The factors which will be used to analyse reasons for adherence are based upon the general theories of international relations. These were presented before I outlined the more specific theories that have derived from realism, liberalism and constructivism. Moral legitimacy, cognitive legitimacy, self-interests and power in negotiations were identified as the specific theories which I will use as independent variables to explain adherence.

As the theoretical framework and the analytical framework have been presented, the next step is to consider the method to be used in this thesis and evaluate the strength of my research design. This is undertaken in the next chapter, which is based upon the theories and analytical model presented here, but with the aim to take the next step in moving towards analysis by presenting the method to be used and the quality of research.

3 Method and Quality of Research

3.1 Introduction

Chapter 2 outlined the formal properties of the argument that will be made in this thesis. The causal model which was developed will provide the structure of the argument throughout the project. This chapter will turn to the adjoining issue of how the research design is constructed. The section will build on the framework of demonstration provided by Gerring (2005: 182-190) which outlines seven factors which characterise quality in research within the social sciences, also referred to by Gerring as methods of proof. These factors are plentitude, comparability, independence, representativeness, variation, transparency, and replicability (Gerring, 2005: 182). However, Gerring's framework focuses on the criteria that research should live up to, and does not offer a more specific method. Therefore, before I turn to Gerring's framework for research, I will show how my method falls in line with the method of congruence as described by George and Bennett among others. The aim of this chapter as a whole is thus to arrive at a better understanding of the dynamics of the research conducted in this project, the relationship between variables, and the validity of the project. I will argue that the research design is sound and well positioned within the standards of how to conduct research in the social sciences, and show evidence of these arguments throughout.

3.2 The Congruence Method

The congruence method as referred to by George and Bennett's also goes under the name of pattern-matching by other scholars. Attractive features of the method include the ability to find evidence for causal relationships without extensive data on each case because the investigator does not need to trace the causal process in details. The method is also flexible and adaptable. Through this method of researching the investigator uses established theory to test its ability to explain or predict an outcome (George and Bennett, 2005: 181), which is what this thesis aims to do. What the researcher is looking for is the independent variable and

the dependent variable to be congruent, meaning that they vary in the expected direction, to the expected magnitude, and along expected dimensions (George and Bennett, 2005: 183). George and Bennett explains that using the congruence method involves determining the value of the independent variable and then use the theory to explain or predict what the outcome on the dependent variable will be. If the outcome of the dependent variable is consistent with the prediction from the theory there may be a causal relationship (George and Bennett, 2005: 181). Although I will start by determining the dependent variables rather than the independent variable in empirical chapters 5 and 6, the aim and method still corresponds to George and Bennett's writings. The aim is to use existing theory and test the compatibility between theory and reality.

Chapter 4 will conduct a theory-guided analysis of the legitimization strategies of the OECD with regards to the Model Tax Convention. It will check which one of the legitimization strategies presented by Suchman; pragmatic, moral or cognitive legitimization corresponds to the trends observed by the OECD. I will bring the information gathered here into the following chapters which focus on explaining why states adhere to the Model Tax Convention. The legitimization strategies observed may have had an impact on why states choose to adhere to the Model Tax Convention, but the other factors represented by the independent variables will also be investigated using the congruence method.

Searching for congruity between the independent variables and the dependent variable is the central aim of my research. The method which will be used seeks explanations for the level of adherence and is thus consistent with the notion of “searching for explanations” or “building explanations” (Yin, 1981: 61). Campbell (1975) describes this search for explanations as a pattern-matching process whereby theory is tested with regards to its ability to explain situations and processes in the empirical world. It is thus not a single variable or factor which is being tested, but rather an explanation is tested (Yin. 1981: 62). These descriptions of pattern-matching or the method of congruence corresponds to the method used in this thesis. The independent variables developed earlier in this chapter represent explanations from established theory, which I will use to test the dependent variable of adherence to the Model Tax Convention, and find the explanation which matches the patterns in the data material.

In addition to establishing explanations, my thesis will also focus on weighing explanations in relation to each other. It is unlikely that one explanation is able to account for all the variation observed, and several explanations will always exist. That is why I will use the method of congruence to establish which explanations seem viable and determine which explanation is the most important.

Pattern-matching is the main method which is used in this research project, but I will also conduct one interview with an expert informant. The next section will outline the purpose and methodological characters of using an expert interview in research.

3.3 Expert Interview

In order to obtain more direct and detailed information about taxation treaties, how they are negotiated and the relationship between the OECD Model Tax Convention and the UN Double Taxation Model, I have chosen to conduct one main expert interview. Although my written sources satisfy the need for data-material to answer the research questions posed in this thesis, the interview is an attempt to obtain information which does not exist as written accounts, and which may be able to further expand upon the findings represented in this thesis.

The interview in this thesis was conducted with a bureaucrat in the Ministry of Finance in Norway who works with the taxation treaties that Norway has with other states. It is an unstructured interview and is inductive in nature. The informant's views are particularly emphasised as important, which is in line with constructivist thinking about research and interpretation. The aim is to get a comprehensive view of the subjective perceptions of the interview object, and I have used purposive selection of the sample.

Standardisation is rarely the aim of expert interviews, and is not the main concern in this thesis either. However I recorded the conversation which was transcribed to ensure an accurate reproduction of the information gathered. In addition, some considerations should be made about the nature of expert interviews in an unstructured mode which will have

implications for the data obtained through the interview. Berry (2002: 680) notes that interviewers should remember that “It is not the obligation of a subject to be objective and tell us the truth. (...) They're talking about their work and, as such, justifying what they do. That's no small matter”. Although my informant is not affiliated with any political party and is not supposed to bring political preferences into consideration, the informant is likely to be shaped by the surroundings. Particularly, I have only conducted an interview with a taxation bureaucrat from Norway which, as a typical OECD member state, has different preferences and positions than other countries regardless of political management. However, the information obtained in the interview takes note of these biases, and the interview is used mainly to shed light on processes which are not described in written accounts. Some implications for validity and reliability are expanded upon in the next section.

It should be noted that during this project I have had the opportunity to attend the OECD Forum 2014 in Paris. This is a conference hosted by the OECD itself which brings together policy-makers, civil society, bureaucrats and journalists. During the conference I obtained more in-depth knowledge of the OECD as an organisation, and information gathered from the speakers and discussions may also have influenced the writing in this thesis.

3.4 The Quality of Research

Plentitude in Gerring's framework refers to the evidence base of research. According to his standard, causal relationships are better tested with more comparative references at hand (Gerring, 2005: 182). All other things held equal, larger samples create better evidence to support an argument and larger samples help specify a proposition as results are more stable if the evidence base is larger.

This thesis draws on several sources of evidence. The Model Tax Convention and the extended document published by the OECD, the reservations that states have made towards the Model Tax Convention and a sample of bilateral taxation treaties are the main sources of information in this project. The document is further outlined in chapter 4 which is based upon information communicated by the OECD as an organisational actor. Chapter 5 addresses the

reservations which are conveyed in the OECD document. This part of the research project uses the entire population of reservations to the principle of exclusive taxation right on the income of royalties to the country of residence. The analysis conducted in chapter 5 is thus a large-N study where the sample equals the population. Bilateral taxation treaties are used primarily in chapter 6. The sample here is smaller, but more refined. Taxation treaties are selected based upon the reservation profile of countries made in chapter 5.

The interviews conducted will add insight where it is needed. By using informants with broad experience within the field of taxation treaties, data which cannot be obtained from written data-material can be brought into the analysis.

In addition to these primary sources, existing literature is consulted and referred to throughout the thesis.

Comparability refers to equivalence across cases, or unit homogeneity (Gerring, 2005:183). There are two aspects of comparability which should be taken into account, namely descriptive comparability and causal comparability (Gerring, 2005: 184-185).

Descriptive comparability means that variables and the meaning behind the concept of the variables mean roughly the same thing across cases (Gerring, 2005: 184). The variables outlined in the previous chapter will be applicable through the entire thesis. Pragmatic, moral and cognitive legitimation will be identified in the same manner throughout the analysis. The same is true for moral and cognitive legitimacy, self-interests and negotiation power. Adherence as the dependent variable will refer to adherence to the Model Tax Convention throughout the thesis.

Causal comparability refers to the similarity between cases, and means choosing cases that are similar to each other with regards to the relationship between the dependent variable and the independent variables (Gerring, 2005: 185). The causal relationship states that legitimacy, negotiation power or self-interests cause the level of adherence if (and only if) their existence

raise the probability of higher adherence to the Model Tax Convention. The causal relationship between the independent variables and the dependent variables is the same for both chapter 5 and 6 which focus on the explanatory power of the independent variables on the level of adherence. Chapter 4 investigates which legitimization strategies the OECD has used and thus has a different logic than the other empirical chapters. However, as this question aims to answer a different research question, the causal logic is also different.

Independence of cases address the potential problem of autocorrelation and cases not being independent (Gerring, 2005: 185-186).

A problem here may be the differentiation between countries which are members of the OECD, and countries which are not members of the OECD. If member-states' adherence is influenced by membership in the OECD, there is a chance that they cannot be compared to states outside the OECD when it comes to the question of adherence. In fact, as we will see in chapter 5 there is a good chance that member-states are indeed more likely to adhere to the Model Tax Convention because they are members of the OECD. The lack of independence between cases can be controlled via some informal method of control (Gerring, 2005: 186) and in my thesis this will be done by not treating member-states of the OECD and non-member states as the same. Instead, I will be open about the differences and use these as an element in my analysis.

Representativeness of cases is another way of referring to the external validity, or the comparability between the sample and the population (Gerring, 2005: 186). The central question is whether it is possible to generalise the findings from the sample to say something about the population as a whole. In chapter 4 I assess the legitimization strategies of the OECD, and no generalisation is needed. In chapter 5 I use the entire population which mean that there is no sample, and the research is representative by default.

Chapter 6 may represent some selection bias, and the sample may not be representative for the entire population of taxation treaties in existence. The fact is that no sample of bilateral taxation treaties as small as the one examined here, would be likely to properly represent the entire population. However, with a volume of more than 3000 taxation treaties in existence, and a qualitative approach to examining them, it would be a task far beyond the scope of this

thesis to arrive at a representative sample. The strategy for selecting the sample will however be described in detail in chapter 6 and the selection of the sample is properly justified. Thus, I believe that the sample in question still has a great value on its own, even though generalisations here may be difficult.

Furthermore, the interview conducted may also represent some level of bias. The views expressed in the interview may not be representative for all states or actors working with taxation treaties worldwide. Therefore, the views expressed are not interpreted as being representative for all negotiators or managers of taxation treaties, but rather the information obtained is considered valuable insights into the process and purposes related to taxation treaties, and are of importance in their own right.

Variation refers to the causal relationship between the variables, and implies that there should be some correlation between independent variables and the dependent variable (Gerring, 2005: 188). The selection of samples should allow for the possibility of variation on the dependent variable, according to King, Keohane and Verba (1994: 129). If the dependent variable is allowed to vary, then correlation and direction of the relationship between the independent and the dependent variables can be determined.

This project is deductive in its nature and will attempt to explore the causal relationship. It will try to determine which one of the independent variables has the most explanatory power on adherence. Thus, it is difficult to say something about the correlation at this point. However, the independent variables have been chosen because I assume that at least one of them has the ability to explain variance in adherence. It would be disappointing to conclude that none of the independent variables have any variation with the dependent variable. It is concluded that the independent variables do correlate with adherence in the empirical analysis, and thus variation is present in this research project. The selection of samples will focus on finding cases which are expected to have different values on the dependent variables and independent variables in order to test the relation.

Transparency is a trait of a research design which provides process-tracing evidence (Gerring,

2005: 189). The causal chain must be accounted for in order for this to be the case.

Throughout this thesis I will strive to explain the causal relationship between independent variables and the dependent variable. For example, it may be found that moral legitimacy explains adherence amongst states. If this is the case, I will go further and make an attempt at explaining why moral interests are so dominant that they result in adherence.

Replicability refers to the reliability of the results and the possibility of repeating the study for future researchers (Gerring, 2005, 189-190). As the majority of sources used in this thesis are readily available to the general public, there is no problem of other researchers finding the same material and doing the research again. However, throughout the project I will rest findings upon interpretations which are accounted for in the analysis. I believe that interpretation is an important tool in understanding the dynamic of processes, and as Adler notes, “the material world does not come classified, and, therefore, the objects of our knowledge are not independent of our interpretations and our language” (2002: 95). It is clear that the interpretations that I make throughout this research project are dependent on me as the researcher, and that other researchers may end up at different conclusions than those presented here, as in the nature of qualitative research projects. However, in order to ensure the replicability of this study, the arguments will be visibly built up and accounted for so that others may understand how I have arrived at the conclusions.

The same logic applies to the interview conducted in this thesis. Had other researchers conducted the interview it may have unfolded differently and other information may have surfaced. Through the same process of making information available to the reader and justifying the conclusions that I make based upon this information, I hope that the thesis will provide the transparency which is necessary in order for others to reach the same conclusions as I have.

3.5 Summary

The purpose of this chapter has been to outline the method to be used in the empirical chapters and examine the quality of my research design. I will use the method of congruence or pattern-matching to investigate whether the independent variables have the power to explain the legitimization strategies of the OECD and the level of adherence to the Model Tax Convention observed. In answering the first research question of how the OECD has legitimated the Model Tax Convention, I will conduct a theory-guided analysis and search for the legitimization strategies which best explain the strategy employed by the OECD. Chapters 5 and 6 both aim to answer the second research question of why countries adhere to the Model Tax Convention, and here I will start by determining the level of adherence, or the dependent variable, and then find the independent variable(s) which best explain adherence. Where I find that several independent variables have congruence with the dependent variable I will evaluate the explanations and determine which has the most explanatory power. This chapter has also outlined the quality of the research design by following Gerring's criteria for good research designs, and found that the research design is sound according to his standards.

4 Analysis of the OECD Model Tax Convention document and the UN Model

4.1 Introduction

The document which the OECD regularly updates and publishes is a source of extended information which can be of help when answering the research questions posed in this thesis. The first research question specifically address how the OECD has proceeded in legitimating the Model Tax Convention, and in analysing how the organisation portrays the model it may be possible to find evidence of which independent variable is best able to explain how the OECD has gone about in encouraging adherence to the model. By looking at the text that the OECD has written to outline and explain the purpose and intention of the OECD Model Tax Convention, I hope to find some indications of the legitimisation strategies of the OECD, based on the analytical concepts developed in chapter 3. The way the OECD as an organisation portrays the Model Tax Convention can be seen as a way for them to legitimate their own policies. As the legitimisation strategy of the OECD is the topic of this analysis, the issues of negotiation power and self-interest are not relevant. This chapter will start by outlining the document in question. It will then go on to look specifically at one part of the document, namely the introduction which can be used to understand the intentions of the OECD. In order to properly examine the legitimisation of the OECD Model Tax Convention, I will also outline the alternative UN Model Double Taxation. This model taxation treaty diverts significantly from the OECD Model when it comes to policies regarding the taxation of royalties which is the particular area of interest for this thesis. Considering this alternative model will place the OECD Model Tax Convention into a larger context. The legitimisation strategies of the OECD will be examined in the last part of the chapter.

4.2 The Model Tax Convention and the OECD publication

The OECD Model Tax Convention in itself is only approximately twenty (20) pages long, but the full version of the OECD publication which it is part of, exceeds two thousand pages. The full document includes not only the Model Tax Convention, but also a range of other information. The OECD Committee on Fiscal Affairs has written an introductory chapter which will be central in this chapter of my thesis, and will be outlined in further detail below. The Committee consists of representatives from OECD member states who meet annually, but the secretariat of the OECD are the ones who carry out the day to day work of this Committee (oecd.org, 2014). The full document also includes commentaries relating to each Article of the Model Tax Convention, OECD-member state's positions on the Model Tax Convention and its Commentaries, some non-OECD countries' positions on the Model Tax Convention and its Commentaries, as well as twenty-four (24) reports related to the Model Tax Convention and Appendixes which outline the tax conventions between OECD member countries and some recommendations from the OECD Council (OECD, 2012). Integrated into the publication is also a detailed history of all the updates, amendments and exclusions which has been made to the Model Tax Convention, the Commentaries, and the positions of both OECD members and non-members throughout the years since the first publication was issued in 1963. Within this document then, there is extensive information which can be used in order to interpret the actual OECD Model Tax Convention, its influence and context. The parts of this document which are particularly interesting for this research project are the sections outlining member-states' and non-member states' reservations to the Model Tax Convention, the OECD introductory chapter and the Model Tax Convention itself. The reservations will be dealt with in chapter 5 which will directly analyse reservations. The Model Tax Convention and the proposition on exclusive taxation rights for the country of residence was used as a source in the introductory chapter, and adherence to this proposition is the topic of chapters 5 and 6, but is also referred to regularly throughout this thesis. This chapter will focus on the OECD's introduction, and the information it provides on OECD's legitimization strategy.

The introduction is about 20 pages long and is written by the OECD's Committee on Fiscal Affairs. This Committee consists of representatives from OECD member states and the

OECD secretariat that meets annually to review and contribute to the work of the secretariat (OECD.org, 2014). As the introduction will be outlined further below, for now it is sufficient to say that it contains a section outlining the historical background of the OECD Model Tax Convention, a section on its influence and a presentation of the Convention.

The Commentaries provided by the OECD is intended to illustrate and interpret each Article's provisions (OECD, 2012: I-8). They are not intended to be included in the bilateral taxation treaties, but are to be seen as an assisting tool in the application and interpretation of the agreements, and to be used as guidelines in the settlement of any disputes if they should arise (OECD; 2012: I-9). The Commentaries are very technical and outline different situations where countries may experience diverging interests in taxation practises. These are supposed to be of guidance for tax authorities, taxpayers and court systems (Appendix 2, 2014 [interview]). The OECD member state's observations and reservations follow the Commentaries of each article. Observations are the main arena for member states to comment on the Model Tax Convention themselves if they feel that the OECD Commentaries do not suffice to express their intentions, or if the Commentaries fail to capture an aspect of a given taxation situation. The reservations are shorter pieces of text which simply express whether or not the member countries adhere to the article. In short, observations are related to the Commentaries, while reservations are related to the article of the Model Tax Convention itself. After each Commentary and the member states' views follow a detailed list of historical changes. As the Model Tax Convention is updated regularly, the OECD has decided to include this account of historical changes so that anyone can follow the developments of the Model Tax Convention, but also the developments of the Commentaries, the observations and the reservations. The historical changes are very detailed and usually exceed the Commentaries, observations and reservations in length.

The next section of the OECD document is the non-OECD economies' positions on the OECD Model Tax Convention. First, a short introduction is given, explaining the reasons behind the decision to include non-OECD members' positions on the Model Tax Convention, and naming the 31 countries which have been given the opportunity to share their positions. The non-member states' positions are limited to outlining, and in some cases (very) briefly

explaining, the reservations. The positions are divided into two categories also here, positions on the article itself, and on the Commentaries. Positions on the article are very short and simple and outline which aspects the non-member countries reserve themselves from. Positions on the commentary are marginally more explanatory and state which aspects of the Commentaries the non-member states disagree with. However, compared to the member states' possibility to share their observations, non-members are not given the opportunity to comment further on why they disagree with the Commentaries. A list of historical changes is included also here, after the positions on each article. Thus, it is easy to track the development of reservations made also by non-member states.

The parts of the OECD document which has been outlined so far constitute Volume I, and contain the parts which are of interest for this thesis. Volume II contains reports written by the OECD on different aspects which the Model Tax Convention addresses, as well as appendixes. Volume II does not address member-states' or non-member states' relationship to the Model Tax Convention, nor does it address the OECD's strategy or relationship to the Convention, and will therefore not be included in this analysis.

It is therefore Volume I which is the main source of information relating to the research questions posed in this thesis. The reservations which both the member states and non-member states have made will be used extensively in the next chapter to provide a full picture of reservations made to Article 12, and to analyse the meaning of these reservations. This chapter will now turn to the OECD's Introduction to the Model Tax Convention which is used to analyse OECD's strategy for legitimating the Model Tax Convention as a direct way of answering the first research question posed.

4.3 OECD's Introduction

As mentioned briefly above, this introduction written by the OECD's Committee on Fiscal Affairs contains the historical background of the Model Tax Convention, an account of the influence that the Model Tax Convention has had, and a presentation of the Model Tax

Convention. This chapter of the OECD publication differs significantly from the rest of Volume I on several points. The other chapters follow a structure based upon the articles of the Model Tax Convention, and go through these articles in detail. The Model Tax Convention outlines the standards that the OECD recommends to base bilateral taxation treaties upon, and the remaining chapters expand upon these and describe them in detail. The introduction on the other hand, is a text that flows much more freely and does not follow the same pattern. Rather than explaining the articles it focuses on the Model Tax Convention in general. It is the views of the OECD that is presented in the introduction, and I expect that the OECD will make use of such an opportunity to justify the content of the Model Tax Convention, and that it will reflect the legitimisation strategies of the OECD. Therefore, I will analyse the introductory chapter using the independent variables developed from Suchman's categories of legitimisation.

The introduction is eleven (11) pages long, and provides important information of the OECD's legitimisation of the Model Tax Convention. The very first paragraph starts by defining juridical double taxation, and stresses that the potential of double taxation has harmful effects on the exchange of good and services, and movements of capital, technology and persons (OECD, 2012: I-1). It emphasises the shared importance that the OECD member countries put on clarifying, standardising and conforming rules of taxation, so that common solutions can be found to identical cases of double taxation. The Council of the OECD recommends that member countries use the Model Tax Convention, its Commentaries and the reservations and positions of other member countries when they deal with negotiating or updating bilateral taxation agreements, and also when they apply and interpret the provisions agreed upon in these agreements.

The content of the section which outlines the historical background of the Model Tax Convention will not be carefully considered here, as the main trends regarding the development of the Model Tax Convention were dealt with in the introductory chapter of this paper. However, I would like to make some remarks regarding the language used in this section. The section stresses the importance of the 1963 publication of the OECD Model Tax Convention (then entitled "*Draft Double Taxation on Income and Capital*") in relation to

previous attempts at eliminating double taxation. It notes that no previous attempt at multilateral processes had succeeded at being fully and unanimously accepted, and that these previous attempts contained gaps and discrepancies (OECD, 2012: I-1 – I-2). The language used includes phrases such as “*harmonization of these conventions (...) became increasingly desirable*” and “... *a draft convention that would effectively resolve the double taxation problem...*” (OECD, 2012: I-2), thus portraying the issue of double taxation as an imminent problem in the international political economy which the OECD stepped up to efficiently resolve. The way in which the sections is written has a clear undertone which portrays the OECD Model Tax Convention as a comprehensive document which the international community had long awaited.

This portrayal becomes even more evident when the introductory chapter turns to the issue of outlining the influence of the OECD Model Tax Convention. This section highlights the wide repercussions that the Model Tax Convention has had on negotiations, application, and interpretation of taxation agreements. It stresses the major importance that the Model Tax Convention has had for OECD member countries. It states that “*The existence of the Model Convention has facilitated bilateral negotiations between OECD member countries and made possible a desirable harmonization between their bilateral conventions for the benefit of both taxpayers and national administration*” (OECD, 2012: I-4). It uses the increasing number of double taxation treaties which has been concluded or revised since the Model Tax Convention first appeared, and the fact that taxation treaties between OECD member countries to a large extent follow the recommendations and standards provided in the Model Tax Convention, as direct measurements of the progress towards eliminating double taxation and the importance of the Model Tax Convention (OECD, 2012: I-4). In addition the section emphasise the importance of the Model Tax Convention also outside of the OECD member countries; “*the impact of the Model Convention has extended far beyond the OECD area*” (OECD, 2012: I-4). The fact that it is being used in negotiations between OECD members and non-members, and also between two parties which are non-members, is taken as evidence of the growing importance of the Convention.

The most notable instance of the influence of the Model Tax Convention, it argues, is the emergence of the UN Model Double Taxation Convention. The OECD stresses how it reproduces a significant part of the OECD Model Tax Convention, which is interpreted as clear proof of the Model Tax Convention's influence beyond the OECD sphere (OECD, 2012: I-4). The UN Model and its relationship to the OECD Model Tax Convention will be expanded upon in the next section.

Lastly the section on the Model Tax Convention's influence notes that the worldwide recognition of the Model Tax Convention's interpretation in the Commentaries has given the world a common standard upon which to agree and interpret double taxation treaties. It also states that as the network of such taxation treaties expands, the provisions of the Model Tax Convention will continue to increase in significance.

These phrasings of the introductory chapter for the Model Tax Convention document published by the OECD makes it clear that the OECD views this particular Model for taxation agreements to be of vital importance with regards to concluding and interpreting taxation agreements bilaterally. The OECD portrays the Model as the most important tool for negotiating taxation treaties, which has had extensive influence within the OECD and beyond. The introduction does not explicitly justify the morality of the Model Tax Convention, but rather takes the moral standing of the Model Tax Convention for granted. Similarly, the benefits states have in using the Model Tax Convention are not justified or discussed, but instead the OECD take it as a given that the Model will serve the interests of states. These aspects and implications of legitimization strategies will be returned to in section 4.5, but first the UN Model Double Taxation Convention will be examined to help shed light on the positioning of the OECD Model Tax Convention.

4.4 The UN Model Double Taxation Convention and its relationship to the OECD Model Tax Convention

The UN Model Double Taxation Convention is an alternative model for negotiating and concluding taxation treaties between countries. Four years after the first OECD Model Tax Convention was published in 1963 as the “*Draft Double Taxation on Income and Capital*” (OECD, 2012: I-1 – I-2) the Economic and Social Council of the United Nations (ECOSOC) adopted a resolution which recognised the desirability of a model for taxation treaties between developed and developing countries (UN, 2011: vii). The 1963 OECD Draft Double Taxation on Income and Capital was met with considerable scepticism from developing countries who felt that the Convention deprived them of tax income which they needed in order to facilitate development (Brooks, 2007:175). The UN Model thus emerged as a result of developing countries' dissatisfaction with the initial OECD Model Tax Convention. The OECD Draft was being used as a guide in taxation treaty negotiations between developed and developing countries despite the Draft being the result of negotiations only within the OECD member states (Surrey, 1980: 7). The Secretary-General of the United Nations responded to the resolution by initiating the “Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries” in 1968 (UN, 2011: vii) with the purpose of addressing developing countries' suspicious attitudes towards the OECD Model Tax Convention and the differences in ideological approaches (Surrey, 1980: 7). The Ad Hoc Group of Experts concluded its work in 1979 and the first UN Double Taxation Convention was approved by ECOSOC in 1980 (UN, 2011: vii-viii).

The Ad Hoc Group of Experts consisted of tax officials and experts from both developed and developing countries and the members were appointed due to their experience and expertise within taxation matters, and were representatives in their personal capacity (UN, 2011: vii). During the discussions which lead to the publication of the first UN Model Convention in 1980, the OECD Draft from 1963 was used as a basic guide to facilitate orderly discussions (Surrey, 1980: 7). However, the result published in 1980 diverted from the OECD Draft with regards to the content of the propositions. The main divergence between the two models, in 1980 as well as today is the OECD bias towards taxation in the residence country and the UN bias towards taxation in the source country. An important assumption of the OECD was that “the country of source will considerably reduce both the scope of its jurisdiction to tax at

source and the rates of tax where jurisdiction is retained”, which was an assumption that developing countries did not accept (Surrey, 1980: 8-9). After the UN Group of Experts had discussed and negotiated, they ended up with propositions which generally favoured retention of greater source country taxation rights (UN, 2011: VI).

The difference in emphasis on taxation in the state of residence versus the source state becomes evident if we turn to the paragraphs of each model which considers the taxation of royalties. Due to the subtle nuances in the language used however, the difference may not be immediately evident. The OECD Model Tax Convention states that: “Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State” (OECD, 2012: M-34). Through this paragraph the OECD establishes the principle of exclusive taxation rights of royalty payments to the state of residence by using “...shall be taxable only in that other State” (OECD, 2012: M-34, emphasis by author). The Article then goes on to define royalty payments and some special exceptions. This zero-rate on taxation of royalties in the source state was not accepted by developing countries (Surrey, 1980: 40). The UN Model Double Taxation Convention therefore, states that: “Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State” (UN, 2011: 18). The language of the paragraph is indeed very similar to that of the OECD, but the proposition therein differs in meaning due to the use of the wording “may be taxed in that other State” (UN, 2011: 18, emphasis by author). Furthermore, the UN Model does not immediately move on to define royalties, but adds an important second paragraph which states that: “However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed ____ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the royalties” (UN, 2011: 18-19). Through these two paragraphs the UN establishes the principle of shared taxation rights between the state of residence and the source state, with the specific rate of taxation left up to bilateral negotiations. In both the OECD and the UN Models these paragraphs establish the distributive rules of taxation of royalties. In international law, as Vogel (1986) notes, the “shall....only” formulation of the OECD Model Tax Convention is a distributive rule with *complete* legal consequences, while the use of “may” in the UN Model is a distributive rule with *incomplete* or *open* legal consequences (Vogel, 1986: 27). The consequence for the enforcement of

taxation treaties is that a distributive rules with complete legal consequences requires the source state to exempt the income from its tax. If distributive rules with incomplete or open legal consequences are established then the rule does not determine the consequences for the source state in itself (Vogel, 1986: 27). It should be noted that with regards to the model taxation treaties, neither the OECD Model Tax Convention nor the UN Model Double Taxation Convention are legally binding in themselves. However, the taxation treaties that countries negotiate are legally binding, and the implications for taxation law of following the different models become relevant when the bilateral taxation treaties are concluded.

When the OECD stresses how the UN Model reproduces a significant part of the OECD Model Tax Convention in the introduction text which was topic for the previous section, and interprets this as clear proof of the Model Tax Convention's influence beyond the OECD sphere (OECD, 2012: I-4), the OECD neglects to be open about the nature of the UN “reproduction”. The UN Model does indeed follow the same structure and outline as the OECD Model in the sense that the articles and paragraphs are build up in the same manner. However, the guidelines differ considerably in nature. When analysing and comparing the two models what is interesting is not primarily the structure and the numbering of articles, but the policy choices that they advocate. The implications that this representation that the OECD use has for its legitimisation strategies will be considered in the next section.

Before we turn to the analysis of OECD's legitimisation strategy, it should be emphasised that the difference in taxation policies that the two models advocate has large implications in economic terms. The consequences of following one model instead of the other are large with regards to the taxation income of the states involved. It is difficult, if not impossible (at least within the scope of this thesis) to estimate the economic consequences of choosing one model over the other. However, one may imagine a scenario where two states sign a taxation treaty based upon the UN Model where taxation rights of royalties are shared equally between the states. That means that all “payments of any kind received as a consideration for the use of, or the right to use, any copy-right of literary, artistic or scientific work including cinematograph films, *(or films or tapes used for radio or television broadcasting,)* any patent, trade-mark, design or model, plan, secret formula or process, *(or for the use of, or the right to use, industrial, commercial or scientific equipment)* or for information concerning industrial,

commercial or scientific experience”¹ (OECD, 2012: M-34 & UN, 2011: 19) are to be shared equally between the two states. If however the states have based their bilateral taxation treaty upon the OECD Model Tax Convention these payments would be taxable only in the state of residence. When considering such an example it becomes evident that we are concerned with large amounts of taxation income, and the choice of which double taxation model to use is not a trivial matter.

The UN Model Double Taxation Convention is thus an alternative tool to base bilateral taxation treaties upon, and is specifically designed for negotiations between developed and developing countries. The Model diverts from the OECD Model Tax Convention with regards to the policy on where to tax royalties and advocates shared taxation rights between the states of residence and the source state, rather than exclusive taxation rights to the state of residence. The difference in policy has implications for taxation law and economic outcomes, despite the OECD portraying the UN Model as nearly a reproduction of the OECD Model.

4.5 OECD's Legitimation Strategy

This chapter has outlined the content of the OECD publication, particularly the introduction to the document as written by the OECD itself, as well as the UN Model Double Taxation Convention and how it compares to the Model Tax Convention of the OECD. The next point of interest is to understand how the OECD text relates to legitimation strategies that the OECD has employed. To answer the research question posed in this thesis, this section will try to determine which independent variable within the legitimation framework can explain OECD's strategy. In order to ensure transparency, the discussion will provide detailed evidence of how conclusions have been reached.

The introductory text does not refer extensively to the self-interests that states have in signing taxation treaties based upon the OECD Model Tax Convention. The text emphasises the importance of the Model Tax Convention in international taxation matters, but does not go into the details of how taxation treaties benefit individual states. The benefits that each

¹ Emphasised text only present in the UN Model Double Taxation Convention (2011: 19). The remaining text is identical in both the UN Model Double Taxation Convention and the OECD Model Tax Convention.

country would gain from accepting the Model Tax Convention are not highlighted through the OECD introductory chapter, leaving no explicit ground for indicating exchange legitimacy within the pragmatic legitimization framework. There is however a more subtle undertone in the text which indicates that states have an interest in the OECD taking on the role as the protector of taxation matters internationally. *“It has long been recognised among the member countries of the Organisation for Economic Co-operation and Development that it is desirable to clarify, standardise, and confirm the fiscal situation of taxpayers (...)”* (OECD, 2012: I-1). Through statements like this, the OECD indicates that the organisation has responded to the needs of the member countries. In addition, there are no references to the values that the Convention is built upon, and therefore no grounds for states to compare their own dispositional attributes to those of the OECD. In other words, there is no evidence of legitimization based upon pragmatic dispositional matching between the audience and the organisation. Even the section of the introductory chapter which outlines the influence of the Model Tax Convention focus mainly on how the use of the Convention has spread, and lacks mention of its benefit for adhering states. This general lack of focus on benefits for states does not provide sufficient evidence of a pragmatic legitimization strategy from the OECD.

Neither does the text explicitly use normative arguments to explain how and why the OECD Model Tax Convention is the best way to address the issue of double taxation. There is even less focus on moral calculations in the introductory text. The few references that are made about the benefits of the Model Tax Convention address the economic challenge of double taxation, rather than the challenges for social welfare. In terms of consequential legitimization, no effort is made to justify the content of the Model Tax Convention as an accomplishment of the OECD in a normative light, and similarly, the structure of the OECD are not referred to in normative terms, leaving no evidence of structural legitimization efforts. Procedural legitimization refers to the moral standing of the OECDs practices, and the OECD does emphasise the inclusion of positions, observations and reservations from member and non-member states in their introduction. Particularly the inclusion of states who are not members of the OECD may be interpreted as a step towards increasing procedural legitimacy. Although the reasons presented for including non-OECD states are directed towards the benefits these inputs will have for the OECD Committee of Fiscal Affairs in assisting the continued updating of the Model Tax Convention (OECD, 2012: I-3), rather than focusing on the democratic perspective of a more inclusive process, the step can still be seen as evidence for

strengthening procedural legitimacy. The OECD may realise that appearing more inclusive in their work will lead states to view the organisation as having fair and pro-social practices, and therefore include non-OECD member countries in their processes as a legitimisation strategy aimed at increasing moral legitimacy. The introductory chapter to the Model Tax Convention thus provides no evidence of consequential or structural legitimisation strategies, but show evidence of steps taken in order to increase the procedural legitimacy of the OECD.

Cognitive legitimisation strategies can be recognised in the text. Cognitive legitimacy is based upon a less conscious understanding of something as comprehensible, or that something is taken for granted (Suchman, 1995: 582). Rather than explicitly trying to defend or promote the OECD Model Tax Convention, the OECD use selective argumentation and conceal information in order to implicitly promote the Model Tax Convention.

The way in which the OECD portrays the UN Model Tax Convention is the clearest case in point. Rather than mentioning the reasons for the emergence of the UN Model as a response to the dissatisfaction with the OECD Model, the OECD points to the similar structure which is reproduced. Thus it sounds like the UN Model is practically the same as the OECD Model, while in fact the content and guidelines often reflect completely different policies, as section 4.4 concluded. After all, it is the content of the policies we should be concerned with, not primarily the structure and the fact that the articles in the UN Model are numbered in the same way as the OECD Model Tax Convention. The differences between favouring exclusive taxation rights to the income from royalty payments to the state of residence, and advocating shared taxation rights or more source country bias, are many and important. As we have seen, the consequences for income to the state are potentially extremely large. Portraying the UN Model as practically a copy of the Model Tax Convention is therefore misleading. When discussing the influence of the Model Tax Convention the OECD states: *“Most notably, it has been used as the basis for the original drafting and the subsequent revision of the United Nations Model Double Taxation Convention between Developed and Developing Countries, which reproduces a significant part of the provisions and Commentaries of the OECD Model Convention”* (OECD, 2012: I-4). This excerpt represents the only mention of the UN Model Double Taxation Convention in the OECD introductory chapter. Knowing of the historical reasons for why the UN Model emerged, it appears that the OECD is trying to conceal important information from the reader. Concealing this aspect is foremost evidence of how

the OECD omits important information in order to portray the OECD Model Tax Convention as the obvious choice for constructing bilateral taxation treaties.

Similarly, the introduction does not go into the nature of double taxation and its harmful effects on economic activity. In fact, this aspect is not addressed in the entire OECD publication. Rather than showing how double taxation can harm economic activity across borders and may cause companies or individuals to refrain from investing abroad or diversifying production in different countries, the OECD text simply states in the very first paragraph that the harmful effects of double taxation “...are so well known that it is scarcely necessary to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between countries” (OECD, 2012: I-1). The introduction, or the full publication for that matter, never mentions why domestic taxation laws are not sufficient and bilateral taxation treaties are needed. Nor does it reflect on why bilateral taxation treaties are the best option for avoiding double taxation rather than a potential multilateral taxation treaty. The introduction claims that the increasing interdependence and co-operation of states in the international global economy is one of the main reasons why such a Model Conventions is needed (OECD, 2012: I-2), but economic activity is often not limited to one or two countries. In order to avoid double taxation for multinational corporations, it may be more convenient to have a multilateral taxation treaty which could be better suited to deal with the increasing interdependence of economic activity. The General Agreement Regarding Fiscal Cooperation of the OCAM-states from 1971 or the taxation treaty between the Nordic Countries are examples of multilateral taxation treaties (Vogel, 1986: 13). Sol Picciotto (2012) amongst others, go even further and argue for a unitary taxation system which encompasses all states. He uses claims that the current international taxation system is not suited to properly tax multinational companies, as the system was constructed a century ago, and does not take into account the global nature of economic activity today. These questions are not addressed in the OECD text, even though they are highly relevant for a Model Convention which deals with matters of international taxation. This again points towards the OECD using very selective argumentation in their promotion of the importance of the Model Tax Convention.

The findings above can be supported by linking the introduction to the proceeding chapters of this thesis on bilateral taxation treaties. The OECD introduction stresses the influence of the Model Tax Convention by looking at how an increasing number of taxation treaties have been based upon the OECD Model Tax Convention, and by stressing the importance that OECD member countries have put upon creating standardised guidelines for bilateral taxation treaties. However, as we shall see later on, many bilateral taxation treaties are not simply based upon the OECD Model Tax Convention, but adhere also or in some cases even more, to the UN Model Convention. It will also become evident that not all member countries adhere to all the principles put forward in the Model Tax Convention, as can be indicated by the number of reservations that member countries conclude. These facts again show how the OECD chooses to omit important aspects of the international response to the OECD Model Tax Convention, and instead focus on portraying it as the obvious choice of model to base bilateral taxation treaties upon.

The findings above indicate how the OECD is using cognitive language and argumentation to legitimate the Model Tax Convention. By concealing important aspects, by failing to address the limitations of the Model Tax Convention and the criticisms, the OECD portrays the Model Tax Convention as the obvious and most influential model. The OECD wishes to show how the Model Tax Convention is important and make an attempt to show how it should be taken for granted that it will be used by countries that are negotiating taxation treaties, rather than viewing it as a choice. By not explaining the differences between the OECD Model Tax Convention and other existing models, most notably the UN Model, it indicates that the OECD Model is the comprehensible alternative. It merely mentions the UN Model, and when it does, it is to show how it has been influenced by the OECD Model. On the basis of these observations, I find that there is no evidence to support pragmatic legitimization strategies and limited evidence of moral legitimization strategies, but that the OECD is using cognitive legitimization strategies to portray the OECD Model Tax Convention as legitimate.

4.6 Summary

This chapter has focused on the document published by the OECD which contains not only the Model Tax Convention is itself, but also a number of other sections which help give meaning to the Model Tax Convention. The content was outlined in order to provide a clearer picture of the context in which the Model Tax Convention exists, and how the OECD puts a considerable amount of emphasis on explaining it and providing tools for negotiations. Furthermore, the chapter paid particular attention to the introductory chapter, as this section differs from the remaining parts of the publication and can be seen as an attempt from the OECD to legitimate the document. The alternative model for negotiating bilateral taxation treaties that the UN Model Double Taxation Convention provides was also presented from a historical view. This was done in order to shed light on the context in which the OECD Model Tax Convention has developed and exists, and to evaluate the claims of the OECD in its introductory chapter to the Model Tax Convention. The analysis of the introductory section found that the OECD does not explicitly focus on the benefits of the Model Tax Convention for states wishing to negotiate a bilateral taxation treaty. Furthermore, it found that the moral justification for setting these standards have not been highlighted by the OECD in terms of the consequential or the structural legitimacy of the Model Tax Convention. Taking the step of including non-OECD member countries into the process of evaluating the Model Tax Convention can however be seen as a strategy for increasing the procedural legitimacy. The justification for including non-member states have been argued for by using the benefits these inputs provides for the OECD itself, but the move may have been taken in order to increase moral legitimacy. However, cognitive legitimization strategies from the OECD seem to be the most apparent as demonstrated by the concealing of important aspects, failing to address the limitations of the Model Tax Convention and the criticisms which have been voiced against it. The OECD portrays the Model Tax Convention as the obvious and most influential model. Taking steps to increase the moral legitimacy of the Model Tax Convention, while failing to openly explain the nature of this strategy seems to correspond to the predominant cognitive legitimization strategy.

5 Analysis of Reservations

5.1 Introduction

The focus for analysis so far in this thesis has been the first research question which addresses the legitimisation strategies of the OECD. The previous chapter found that the OECD has used mainly cognitive legitimisation strategies to justify the Model Tax Convention. This chapter will shift the focus towards the second research question posed, the aim of which is to discover why countries adhere to the Model Tax Convention. Several sources of information will be used to answer this question, and in this chapter the reservations that countries have made, or not made, will be the main focus. Chapter 6 will look at a sample of actual bilateral taxation treaties, but in order to have a good understanding of why these follow the provisions of the OECD or not, the reservation system will be outlined. As this chapter will demonstrate, reservations are important pieces of information which reflect the dependent variable of adherence.

Instead of looking at the OECD as an organisation, this chapter will turn to the responses of countries to the Model Tax Convention.

The reservations that countries make can be seen as a direct indication of lower adherence to the Model Tax Convention. If a country does not agree with an aspect of the OECD Model Tax Convention, the best way to show this and to act upon the disagreement is to reserve itself from having to adhere to this aspect. Countries are encouraged by the OECD to respect not only the guidelines that the Model Tax Convention provides and the Commentaries to interpret them, but also each individual country's reservations when conducting bilateral negotiations. Looking at the reservations is therefore a solid way to understand how OECD member countries' as well as non-member countries' attitudes are towards the Model Tax Convention. However, the scope of this chapter will not be to look at all the reservations made. Rather, attention will be focused on countries' attitudes towards the article of the Model Tax Convention which deals with withholding tax on royalties which is the focus of this thesis. This topic is covered in Article 12 of the Model Tax Convention. Paragraph 1 of this

article lays out the principle of exclusive taxation rights to the country of residence. Reservations to this particular paragraph are therefore the main focus throughout this chapter.

In order to clarify the level of adherence to the OECD Model Tax Convention, it would be desirable to compare these reservations to those of a comparable model for negotiating taxation treaties. Chapter 4 considered the UN Model Double Taxation Convention and found that this model advocated a different policy on where to tax royalties, which favoured source countries to a greater extent than the OECD does. Therefore, ideally we would be able to look at state's attitudes towards the UN Model and compare the adherence of the UN Model to that of the OECD Model. If a state had reserved the right to tax royalties at source in the OECD Model, but had made no reservation to the UN principle of shared taxation, adherence to the OECD Model would be even lower. Similarly, if a country had not reserved itself from the OECD principle of taxing royalties in the state of residence, but had reserved itself from the principle of shared taxation in the UN Model, adherence to the OECD Model would be strengthened. Comparing adherence to the OECD Model Tax Convention with adherence to the UN Model would allow for a clear picture of state's preferences and a more nuanced picture of adherence.

While such comparisons would be useful, the UN Model has been developed by the Group of Experts at the ECOSOC and not by states. Furthermore, the UN Model (as the OECD Model) is not a legally binding document, but a Convention made with the purpose of assisting states in their negotiations over bilateral taxation treaties. The sum of these factors means that states do not have the opportunity to sign or ratify the UN Model. In addition, the UN Model does not contain a system of reservations, and states do not have the opportunity to make observations, reservations or positions on the propositions. The ECOSOC is considering the possibility of introducing a system of including the views of states into the UN Model Double Taxation Convention (UN, 2011b). If the next revision of the UN Model includes such a system, this would be an interesting way to further analyse the level of adherence to the OECD Model Tax Convention as well as the UN Model Double Taxation Convention more precisely, which researchers should consider following up.

This chapter is an attempt to understand how countries, both as members of the OECD and non-members, perceive the Model Tax Convention. Through looking at the reservations I hope to find indicators of whether or not countries tend to adhere to the principle of exclusive taxation rights for the state of residence. Reservations are, in this sense, indicators of the level of adherence which is the dependent variable of this study. Reservations and thus adherence will be explained through an analysis of the independent variables, in order to understand whether calculations of different types of legitimacy or self-interests can explain adherence, in line with the causal model which was developed in chapter 3. As the power in negotiations is a relational explanatory factor, and the reservations are made by one country alone, the independent variable of negotiation power is not relevant for explaining adherence in this chapter, and will therefore be excluded. The reservation picture developed in this chapter will be the basis for the selection of bilateral taxation treaties to be analysed in the proceeding chapter on bilateral taxation treaties. I will include all the countries involved and all the reservations made, and the analysis will thus consider the entire population at hand. Not all countries in the world are included in the process of reviewing the OECD Model Tax Convention, but the 63 countries that are involved are included in the analysis. In terms of Gerring's criteria for good research, this means that the sample analysed is indeed representative for the population because the entire available population is considered. In addition the analysis allows the dependent variable to vary because both countries with and without reservations are taken into account, thus improving variation.

5.2 Reservations to Article 12, Paragraph 1

As mentioned in the introduction to this chapter, reservation can be regarded as disagreement with certain provisions of the Model Tax Convention, thus indicating lower adherence. If a country has reserved itself from any aspect of the Convention, the other country is encouraged to forgo their right to follow this provision, but according to the reciprocity principle that the other part will do the same in another situation (OECD, 2012: I-10). It must however be noted that when the OECD makes this statement it is only with regards to member countries. Non-OECD member states are also allowed to submit their reservations, but interestingly no statement similar to the one above stating that the other party to negotiations have to retain their rights is explicitly mentioned.

Like Rudyk and Vega (2011:3), who have previously used reservations as indicators for disagreement with the OECD Model Tax Convention, it is important to note at the outset that a reservation does not mean an intention to exclude or modify the legal effect of certain provisions, which is the technical meaning of a reservation according to Art.2 (1) (d) of the Vienna Convention on the Law of Treaties (1969). The reason for this deviation is that the OECD Model Tax Convention is a Model rather than a treaty in itself. With regards to the bilateral taxation treaties this is different, as the reservations are taken into account before the treaty is agreed upon and reservations are thus not made directly towards the taxation treaty. Reservations thus mean disagreement with the Convention text and are interpreted as indicating non-adherence to the specific provision the reservation is made towards, rather than to the Convention as a whole.

In order to get an indication of how many countries that have made reservations to aspects of Article 12, I have coded OECD member countries and non-members countries. The full tables can be found in appendix 1, while tables 5.1 and 5.2 provide a summary of reservations. The source of information is the OECD publication. Column 1 in tables 5.1 and 5.2 shows countries which have opted to fully reserve the right to tax royalties at source. These countries do not agree with the principle laid out in the Model Tax Convention, and do not adhere to the principle of exclusive taxation in the state of residence. Column 2 shows the countries which have partially reserved themselves from the OECD principle of exclusive taxation rights to the state of residence. Partial reservations may include special treatments of certain royalties e.g. those arising from copyrights on artistic work. Column 3 shows the countries that have not made any reservations to the OECD principle of taxing royalties exclusively in the state of residence. These countries fully adhere to the Model Tax Convention and have not indicated any disagreement with the OECD with regards to Article 12, Paragraph 1.

Reserve the full right to tax royalties at source	Partial reservations to the principle of exclusive taxation rights to the state of residence	Adhere to the principle of taxing royalties exclusively in the state of residence
Australia	Canada	Austria
Chile	Czech Republic	Belgium
Korea	Germany	Denmark
Mexico	Greece	Estonia
New Zealand	Italy	Finland
Poland		France
Portugal		Hungary
Slovak Republic		Iceland
Slovenia		Ireland
Turkey		Israel
		Japan
		Luxembourg
		Netherlands
		Norway
		Spain
		Sweden
		Switzerland
		United Kingdom
		United States
Total: 10	Total: 5	Total: 19

Table 5.1: OECD member countries' reservations

Reserve the full right to tax royalties at source	Partial reservations to the principle of exclusive taxation rights to the state of residence	Adhere to the principle of taxing royalties exclusively in the state of residence
Albania	India	United Arab Emirates
Argentina		
Armenia		
Belarus		
Brazil		
Bulgaria		
Croatia		
DR Congo		
Gabon		
Hong Kong, China		
Indonesia		
Ivory Coast		
Kazakhstan		
Latvia		
Lithuania		
Malaysia		
Morocco		
China		
Philippines		
Romania		
Russia		
Serbia		
South Africa		
Thailand		
Tunisia		
Ukraine		
Vietnam		
Total: 27	Total: 1	Total: 1

Table 5.2: Non-OECD member countries' reservations

5.3 Trends among OECD member states

Before turning to the issue of explaining these reservations we need a more thorough understanding of the reservation picture which has been presented in the tables above. This section and the next two will therefore identify some trends which can be found in these reservations. This section will briefly analyse the member countries and will look at which types of countries tend to make reservations with reference to whether the state has been a member of the OECD since its beginning, the level of human development and level of capital export. The data used to explore these potential trends is found through lists of member countries at the start of the OECD as an organisation, lists of human development according to the human development index (HDI) and data from the World Bank on FDI outflows. I have used these data to discover whether there are common features which seem to correspond among countries with reservations and countries without reservations.

From table 5.1 information can be found regarding OECD member countries. Ten out of 34 of the member states choose to reserve themselves from Paragraph 1 of Article 12. In 1961 OECD's predecessor, the OEEC gained three more members and was established as the OECD. The original founding members of the OECD are for the most part in the group of member countries who have not reserved themselves from taxing royalties in the state of residence only. Portugal and Turkey are the exceptions to this, and are the only two out of twenty original founding members who have reserved themselves from this principle. The overwhelming support for the Model Tax Convention from the part of the original founding members may signal that those member countries that have been committed to the OECD from the beginning are more likely to adhere to the Model Tax Convention.

Another trend can be found by looking at the human development index. Although all member countries belonging to the OECD are placed in the category of very high or high human development, variation can be found. If we rank the OECD member countries in order of HDI score from highest to lowest, I find that the countries that have chosen to reserve themselves from the principle of exclusive taxation rights to the state of residence are generally placed towards the bottom of the list. The seven countries at the bottom of the list

are Slovakia, Hungary, Poland, Chile, Portugal, Mexico and Turkey (from highest to lowest), and out of these countries only Hungary has not made a reservation to the paragraph. Thus, at the bottom of the HDI ranking list there seems to be a trend of making reservations to the paragraph. The remaining list however, is more random and it should be noted that the second country on the list, namely Australia has also made a reservation. This modest trend reflects a propensity of highly developed countries to be more likely to adhere to the Model Tax Convention.

The OECD Model Tax Convention has been said to be biased in favour of capital-exporting countries due to its bias for states of residence taxation (e.g. Brooks, 2007: 172). Usually it is referred to OECD member states as being the main beneficiaries of the provisions inherent in the Model Tax Convention. If we rank the member states according to their capital-exporting capabilities, similar trends can be found. Using data from the World Bank on capital export (FDI is seen as the best indicator) as a percentage of GDP from 2012 only (worldbank.org), I find that the majority of OECD member countries are indeed capital-exporting countries. The countries that are not capital-exporting are generally either countries who have suffered under the current financial crisis (Iceland and Greece) or countries who have reserved themselves from the principle of exclusive taxation rights for royalties to the state of residence. There is thus a modest trend towards the most capital-exporting intensive countries being represented among the countries that have not made reservations to Paragraph 1 of Article 12, while the less capital-export intensive countries and the capital-importing countries tend to have made reservations. This may indicate that capital-exporting countries are indeed those who benefit the most from taxing royalties in the state of residence.

In summary, there seems to be an overall trend towards original members of the OECD with a high level of human development and capital-export intensive economies, being the most likely to adhere to the OECD Model Tax Convention, based on the reservations made. This observation falls in line with expectations based on claims made by others (Brooks, 2007 and Rudyk and Vega, 2011) that the OECD Model Tax Convention is an instrument mainly designed to benefit the rich developed countries. Rudyk and Vega (2011) statistically test the hypothesis that export-importing countries are more likely to submit reservations to the Model

Tax Convention in general, and find that their data supports the hypothesis. Although Brooks (2007) focus mainly on the differences between developed and developing the observations discovered here seem to confirm that these trends also hold for explaining variation within OECD membership countries. Thus, these findings adds to the existing literature on who benefits from the provisions of the Model Tax Convention, by observing that the level of adherence to the principle of exclusive taxation rights of royalties to the state of residence also differs within OECD member states.

5.4 Trends among OECD non-member states

Table 5.2 represents the reservations made by non-OECD member countries. The table shows that reservations to Paragraph 1 of Article 12 are very common among countries which are not members of the OECD. Only two countries out of a possible twenty-nine (29) have not fully reserved the right to tax royalties at source, which is the recommendation from the OECD. The two exceptions are India and the United Arab Emirates who experience medium and very high human development. India is a net capital importer, while the World Bank does not have data on the United Arab Emirates (World Bank, 2013). Among the countries who have made reservations to the exclusive right to tax royalties in the state of residence, all levels of human development are represented, as well as both countries who are net capital exporters and importers. In other words, it is difficult to find any trends along the same dimensions as above with regards to OECD non-member states.

However, one thing is clear. The main trend to be observed among OECD non-member states is that an overwhelming majority of them opt to reserve the right to tax royalties at source. The next section will address the variation between member and non-member states with regards to reservations.

5.5 Differences between OECD member states and non-member states

Based upon the codings of table 5.1 and 5.2 and the observations of general trends expanded upon above, it is evident that the main trends of reservations is that while the majority of OECD member states do not reserve the right to tax royalties at source, an overwhelming majority of OECD non-member states do. While only just under 30% of OECD members reserve this right, more than 90% of states not part of the OECD do, regardless of level of development or capital exporting capabilities. It is thus clear that OECD member states are more likely to adhere to the OECD principle than non-OECD states.

5.6 Explaining Adherence

What has been demonstrated above is that OECD member states tend to be less likely to reserve themselves from the principle of exclusive rights to tax royalties in the state of residence than non-member states are. This section will try to determine the underlying explanations for these trends in terms of the independent variables identified in this thesis in order to answer the second research question. I will do so by starting with the framework for legitimacy as explanatory factors, and then turn to the self-interest explanation. As the introduction to this chapter noted, the independent variable of negotiation power will not be included in the analysis here as it is not a relevant factor for the analysis. In order to improve transparency as a factor of good research described by Gerring (2005), each independent variable will be discussed properly in this section to allow readers to understand how I have arrived at conclusions.

Moral legitimacy is the first possible explanation for adherence. The fact that member countries of the OECD are more likely to adhere to the Model Tax Convention than countries which are not members, may have something to do with their view on the organisation's moral standing. Particularly, Suchman defines procedural legitimacy as a form of moral legitimacy where the organisation is perceived as having “sound practises” (Suchman, 1995: 580). Member states are located closer to the processes of the OECD, and are therefore more likely

to observe and understand the practises of the organisation and have the opportunity to view them as sound and legitimate. Non-member states on the other hand, observe the outcomes of the OECD without having an impression of how the practises of the organisation transpire in day to day life. However, as the previous chapter noted, the inclusion of non-member states into the process of reviewing the Model Tax Convention may have strengthened the procedural legitimacy of the Model Tax Convention as it brings non-OECD member states closer to the practises of the OECD. The trends discovered above, point only to the fact that member-countries of the OECD are less likely to make reservations to the principle of exclusive taxation right of royalties to the state of residence, while non-member countries tend to make reservations to this principle. As literature has indicated, the perception amongst developing countries (non-OECD member states) that the Model Tax Convention benefits mainly developed countries (OECD member states) triggered the work of establishing the UN Model Double Taxation Convention (Surrey, 1980: 7). This indicates that non-OECD member states in fact were suspicious towards the OECD Model Tax Convention and them not being included in the process of developing the Model, which indicates weaker moral legitimacy for non-OECD states. Similarly, consequential legitimacy in which a country base its evaluations of an organisation upon its accomplishments, may be stronger for member-states of the OECD than for non-member states due to their position as observing the accomplishments from a closer range.

This chapter also found that original OECD members are more likely to adhere to the Model Tax Convention than OECD member-states which have become part of the OECD at a later stage. This may be explained in terms of moral legitimacy in the same manner as the difference between member states and non-member states. Original OECD members may feel that the OECD has proved itself to be an organisation which promotes social welfare in a satisfying manner over the years and thus choose not to make a reservation because the OECD knows what the “best thing to do” is from a pro-social perspective.

Cognitive legitimacy is according to Suchman (1995: 582) achieved if an organisation's audience accept the organisation as necessary or inevitable. Cognitive legitimacy is recognised by a lack of explicit evaluations. The reservations that member-states and non-member states make towards the Model Tax Convention is evidence that countries do not take

the OECD and their principles for taxation as a given. Rather than accepting the propositions of the OECD as comprehensible or take them for granted, states evaluate the propositions and the reservations can be seen as evidence of these evaluations having found place. In other words, the data material used in this chapter shows us that there is a low level of cognitive legitimacy. Although not all states involved in the process of evaluating the Model Tax Convention have chosen to make a reservation, the existence of reservations at all is evidence that states do not take the Model for granted, and there is no reason to believe that the states which have not reserved the right to tax royalties in the source state have refrained from calculating the proposition in the Model Tax Convention. Low cognitive legitimacy therefore cannot have the ability to explain variance in adherence.

Self-interests was in Chapter 3 defined as a realist explanation for why states act as they do. The theory says that states will act in a manner which increases their own benefit. That means that states will adhere to the Model Tax Convention if it serves their self-interest. In addition, Suchman defines pragmatic legitimacy in the same manner, showing that self-interest is not simply a factor within the realist tradition.

If self-interests explain adherence, countries with high levels of human development which are net capital-exporting countries are likely to adhere to the Model Tax Convention on the issue of where to tax royalties. This is because taxing royalties in the country of residence is most beneficial for high-income countries, and many argue that the Model Tax Convention in fact ensures that income is transferred from low-income countries to high-income countries, and ensures low taxation for multinational companies (Brooks, 2007:171 and Sheppard, 2012: 467). The reasoning behind this argument is that high-income countries tend to be the ones who invent products, services and knowledge which gives rise to royalties, while low-income countries often provide the area of production. It is believed that the state which gives rise to the royalty has provided a set of services for which they should be compensated, such as research facilities, educated scientists and the necessary infrastructure. The OECD consists of high-income states, and taxation of royalties in the state of residence has become the principle within the OECD, which reflects the interests of its member states. However, when producing the goods and services with a royalty attached, low-income countries have to provide certain surroundings which are needed for production such as an educated labour force, a well-

functioning market, the possibility of registering a company and the necessary infrastructure. From the reservations profile developed above, it seems like these countries also believe that they are entitled to some form of compensation through levying a tax on royalties also at source. Thus it becomes clear that the issue of benefit gives rise to reservations from the OECD principle of taxing royalties in the state of residence.

In terms of economic reasoning for adhering to the OECD principle of taxing royalties in the state of residence, the lack of reservations amongst developed countries demonstrate that high-income, capital-exporting countries adhere to the OECD Model Tax Convention because of the self-interest they have in doing so. Similarly, the lack of adherence by low-income, net capital-importing countries signals that they do not view the OECD Model Tax Convention as beneficial. The explanation for adherence based upon the view that states act to defend their self-interests thus seems to be relevant for the level of adherence.

5.7 Why do states adhere to the Model Tax Convention?

After having accounted for the reservations made by states, identified some general trends and analysed these in terms of the relevant independent variables, it is desirable to return to the research question and look at the implications the analysis has for answering the question. The second research question asked “Why do countries from all over the world adhere to the OECD Model Tax Convention and its principle of exclusive right to tax royalties in states of residence?” This chapter has found that in fact states from all over the world do not necessarily adhere to the principle advocated in the Model Tax Convention. Rather, states which are members of the OECD seem to adhere to a certain degree, while non-member states are less likely to adhere. Only two countries outside the OECD with the opportunity to share their positions on the Model Tax Convention have chosen not to make a reservation towards the proposition of exclusive taxation rights to the states of residence. Adherence is thus lower than expected at the outset, but the question of *why* is still relevant; analysing what determines the level of adherence is the essence of answering the research question.

The analysis in this chapter has found that there is a low level of cognitive legitimacy observed among states, because states do make reservations. Not all states have reserved the right to tax royalties in the source state, but the fact that a large number of the countries involved in the process have made reservations is evidence that states do contemplate the content of the Model Tax Convention. It is unlikely that states without reservations have not also contemplated the content of the Model Tax Convention which also signals low cognitive legitimacy even if they end up without reservations. The empirical evidence thus shows that cognitive legitimacy is low regardless of the outcome on the dependent variable and does not explain variance in adherence. Cognitive legitimacy is, on the basis for this reasoning, ruled out as an explanation for adherence.

Moral legitimacy seems to have some ability to explain adherence to the Model Tax Convention. Member-states have a closer proximity to the OECD and may perceive the organisation as pro-social to a larger degree than non-member states. The same principle may apply for original members of the OECD who are more likely to adhere to the Model Tax Convention because they have had the opportunity to observe the work of the OECD for a longer period of time. The previous chapter identified the inclusion of non-member states into the process of evaluating the Model Tax Convention as a source for higher moral procedural legitimacy. However this chapter has demonstrated that such inclusion does not seem to increase adherence, which weakens the trend of increased moral legitimacy. Lastly, it has been observed that the UN Model was constructed due to non-member states of the OECD perceiving the OECD Model as not pro-social from their point of view. Summarised, moral legitimacy is low amongst non-member states, but slightly higher among members of the OECD and particularly those states which were members from the start of the organisation's life. As adherence follows the same pattern; low adherence from non-member states, higher for member-states particularly original OECD members, moral legitimacy accounts for some variation in adherence.

The analysis also established that self-interests seem to account for variation in adherence, as member-states which are more likely to adhere also benefit the most from the policies

advocated in the Model Tax Convention. Capital-exporting states with a high level of development benefit the most from taxing royalties exclusively in the state of residence, and according to theory on pragmatic legitimacy and realist notions of states as maximisers of gains, these states should adhere to the Model Tax Convention, while the opposite should be true for capital-importing states with low levels of development. These theoretical predictions correspond to the patterns in adherence, and self-interests also help explain adherence.

The question at hand at this point is which explanation explains adherence the best; moral legitimacy or self-interests? The explanation of moral legitimacy rests solely upon the assumption that states which have a closer proximity to the OECD as an organisation have a better likelihood of perceiving the organisation as morally sound and pro-social. However, no direct evidence that states close to the OECD have this perception can be found in the data material at hand. Evidence in favour of the self-interest variable however, is based upon evaluations of the capital-exporting capabilities of states and the concrete level of human development. The interview at the Norwegian Ministry of Finance revealed that: “It is in our interests not to have high rates of source taxation on royalties in our taxation treaties. We will in taxation treaties reduce the taxation rates [source rates; author's note] on royalties as a result of other countries' interests” (Appendix 2, 2014 [interview]). This statement further strengthens the evidence of self-interests as the dominant explanatory factor for adherence to the Model Tax Convention. Norway as a capital-exporting country with very high levels of human development and as an OECD member has an interest in adhering to the principle of exclusive taxation rights to the state of residence. The opposite will be true for capital-importing states with low levels of human development, often countries outside of OECD membership.

The most viable explanation for variance in adherence is the independent variable of self-interests. States adhere to the Model Tax Convention and the principle of exclusive taxation rights to the state of residence if they benefit from doing so. Likewise, states reserve themselves from this principle in cases where they do not benefit. Moral legitimacy may also account for some variation in adherence, but without further evidence for moral legitimacy, it is not possible to conclude that moral legitimacy is more important than self-interests in explaining adherence.

5.8 Summary

This chapter has looked at the reservations countries have made towards Article 12 of the OECD Model Tax Convention. By examining the parts of the OECD document which outlines the positions and reservations of both member countries and non-member countries of the OECD, a reservation profile has been made which can be viewed in tables 5.1 and 5.2. Based upon these observations, some general trends in the patterns of reservations and adherence have been explored. There is a clear trend which signals that OECD member countries are more likely to have a higher level of adherence to the convention than non-member countries. Furthermore, countries with high human development, which are net capital-exporters and which have been members of the OECD from the beginning of the organisation's life, tend to adhere to the Model Tax Convention. These trends may be explained in terms of the independent variables this thesis have identified, and it has been shown that cognitive legitimacy is not relevant in explaining the trends, precisely because states issue reservations towards the policies in the Model Tax Convention. Moral legitimacy has some explanatory power with regards to explaining the differences between member states and non-member states, as well as explaining the difference in adherence within member states to the OECD. However, the most important factor of explanation seems to be the variable of self-interest, which shows that the assumption that states act to maximise their own benefit is the single most important factor to account for the variance in adherence to the Model Tax Convention. In order to find out how countries in fact act when concluding bilateral taxation treaties, some treaties will be considered in the next chapter. As the bilateral taxation treaties are legally binding and are the arena where the positions and preferences of the countries can be expressed in reality, these treaties hold a lot of valuable information within them which can help continue understand why states adhere to the Model Tax Convention.

6 Analysis of Bilateral Taxation Treaties

6.1 Introduction

The aim of this chapter is to continue to find coherent ways to answer the second part of the research question regarding why countries adhere to the Model Tax Convention. The previous chapter focused on the reservations that countries have made towards the principle of exclusive taxation rights of royalties to the state of residence, using reservations as indicators for adherence and the aim was to explain the underlying reasons for reservations through the independent variables of legitimacy and self-interest. However, in order to understand how reservations are taken into account in the practical use of the Model Tax Convention, this chapter will look at bilateral taxation treaties. While the Model Tax Convention and the reservations therein are not legally binding, the taxation treaties that countries agree upon are. Bilateral taxation treaties are the main place in which reservations and policy-preferences become evident. It is in the bilateral taxation treaties we can find information about how different interests and preferences are expressed and how the reservations are treated. It is therefore within the taxation treaties that evidence can be found on adherence in practical terms. So while the previous chapter dealt with the perception of the Model Tax Convention, this chapter will turn to its actual influence. The aim is however the same as in the previous chapter, namely to investigate why, with respect to the independent variables, states adhere to the Model Tax Convention. The causal relationship is thus the same as in chapter 5, and although the source of information is different, causal comparability is still strong.

The first part of this chapter will outline the selection of treaties to consider and the content of these with regards to adherence to the Model Tax Convention. Based upon the findings of chapter 5 it is expected that taxation treaties where at least one of the parties to the treaty is not a member of the OECD, the proposition of taxing royalties in the state of residence will not be adhered to. The second part of this chapter will turn to analysis of the pattern of adherence. Using moral legitimacy, cognitive legitimacy, self-interests and negotiation power

as potential explanations for variance in adherence, I will try to determine which variable has the most power of explanation for the outcome of taxation treaties.

6.2 Bilateral Taxation Treaties

The purpose of OECD Model Tax Convention is to provide a standard for how to design and conclude bilateral taxation treaties. As mentioned, the Model in itself is not a legally binding document, but is meant to be used as a guide for countries wishing to negotiate taxation treaties with other countries. The taxation treaties in turn are legally binding for the signatory states, and have repercussions for citizens and companies wishing to conduct economic activity between the two states. The bilateral taxation treaties are the ultimate outcome of the OECD Model Tax Convention, and provide the best basis to understand how countries respond to the principles laid out in the Model Tax Convention. It is therefore natural to look at some examples of bilateral taxation treaties and how these respect the provisions of the Model Tax Convention in light of the reservations that have been made regarding how to tax royalties.

However, as more than 3000 bilateral taxation treaties exist today which are based upon the OECD Model Tax Convention (Bennett and Owens, 2008) it is impossible to carefully examine the extent to which all of these adhere to the OECD Model Tax Convention. Rather, a selection has to be made in order to consider a few of the existing treaties. While the previous chapter used the entire population as a source of data, this part of the analysis will have to select a smaller sample to consider. I have categorised those countries which have explicitly been involved in the process of commenting and providing positions on the OECD Model Tax Convention. All OECD member-countries are included in the categorising, as well as all non-members who are mentioned in the OECD document, under the section “Non-OECD Economies’ Positions on the OECD Model Tax Convention” (OECD, 2012: P). Chapter 5 gave rise to tables 5.1 and 5.2 where reservations are indicated for member and non-member states of the OECD. These are used here to provide the basis for the four categories of states in table 6.1. The first category of states consists of member states of the OECD which have not reserved themselves from taxing royalties in the state of residence. In

other words, they adhere to the OECD principle. The second category is countries which are members of the OECD but have reserved the right to tax royalties at source, and therefore do not adhere to the OECD principle. The same division has been made for states which are not members of the OECD, and while the third category consists of states without reservations, the fourth category contains those countries which have reserved the right to tax royalties at source. Summarised, this makes four distinct categories of countries; OECD member-states with no reservation, OECD member-states with a reservation, non-member states with no reservation and non-member states with a reservation.

In order to consider a variety of bilateral taxation treaties which may better represent the wider population of treaties, I will consider treaties from various categories. Choices of which treaties to consider have been made primarily based upon the categorising of countries, and then secondly based upon convenience and accessibility of taxation treaties, as expanded upon below.

Categories:			
OECD, no reservation	OECD, reservation	Non-OECD, no reservation	Non-OECD, reservation
Austria	Australia	India	Albania
Belgium	Chile	United Arab Emirates	Argentina
Canada	Korea		Armenia
Czech Republic	Mexico		Belarus
Denmark	New Zealand		Brazil
Estonia	Poland		Bulgaria
Finland	Portugal		Croatia
France	Slovak Republic		DR Congo
Germany	Slovenia		Gabon
Greece	Turkey		Hong Kong, China
Hungary			Indonesia
Iceland			Ivory Coast
Ireland			Kazakhstan
Israel			Latvia
Italy			Lithuania
Japan			Malaysia
Luxembourg			Morocco
Netherlands			People's Republic of China
Norway			Philippines
Spain			Romania
Sweden			Russia
Switzerland			Serbia
United Kingdom			South Africa
United States			Thailand
			Tunisia
			Ukraine
			Vietnam

Table 6.1: Categories of states

6.3 Selection of Treaties

This section will outline which treaties are to be analysed in this chapter and the reasoning behind the selection. The reservation profile developed in Chapter 5 is the basis for the categories in table 6.1. Categorising countries in this manner is done so that the selected sample of bilateral taxation treaties to be analysed is diverse and therefore may be representable for the wider population of taxation treaties. Countries which are members of the OECD, not members of the OECD, and those which have made reservations and have not made reservations were chosen, in order to get an impression of how each category of states respond to the existence of the Model Tax Convention in reality. Using different types of countries will also allow the dependent variable to vary, thus increasing variation in the sample. The posed research question asks why countries from all over the world adhere to the Convention, and in order to answer this question, it is important to actually consider taxation

treaties including countries from all over the world with different interests, demands and preferences.

It is desirable to start with a country in the first category where we find OECD member-states without reservations. Twenty-four (24) countries fall under this category, so in order to select one, accessibility will be emphasised. Norway has not made any reservations towards the Article whatsoever, and agrees with the OECD Commentaries without insisting on adding or retracting anything. Norway, therefore, can be considered as a textbook example of an OECD-member state belonging to the first category. In addition, the accessibility of bilateral taxation agreements varies significantly depending on the parties to the agreements and the transparency of official documents in those countries. Bilateral taxation treaties tend to be signed in a maximum of two languages; the official languages of the two countries which are party to the agreement, which makes it difficult to access and understand the content of any given agreement. As I have an obvious close proximity to the Norwegian government and due to the accessibility and language understanding of those treaties, I have chosen to use Norwegian double taxation treaties as a starting point for the analysis of bilateral treaties.

Norway is a member of the OECD which has not reserved itself from the principle of taxing royalties exclusively in the state of residence, which, based upon the findings of the previous chapters is likely to be because of the benefits that Norway acquires from following the OECD proposition. As a high-income, capital-exporting country with a very high level of human development and an original member of the OECD, Norway's adherence to the Model Tax Convention is expected to be high.

First, it is desirable to look at a taxation treaty that Norway has signed with another OECD-member country which is also has not made a reservation to the Model Tax Convention, is localised in the same category, and is fairly similar to Norway. A Nordic country is the most obvious example of a country with major political, cultural, ethnic and, most importantly in this case, economic similarities to Norway. It is also reasonable to assume that the negotiation process between the Nordic countries would be characterised by similar negotiation strength. The Nordic countries have in fact negotiated a taxation agreement which is multilateral rather than bilateral, where Norway, Sweden, Denmark, Iceland, Finland and the Faroe Islands are

the parties to one common agreement. Neither Sweden, Denmark, Finland nor Iceland has made reservations to Article 12 of the OECD Model Tax Convention, and none of the countries has expressed disagreement with the OECD Commentaries. The Faroe Islands is not an OECD-member state, and is also not included in the non-members that have commented and/or made reservations from the Convention. However, the reason for its inclusion to the agreement is that the Faroe Island has its own tax jurisdiction, and has close cultural and economic ties to the remaining parties of the agreement (Norwegian Ministry of Finance, 1996). There is no reason to believe that the inclusion of the Faroe Islands has had much impact on the actual content of the agreement text, and the agreement can therefore be seen as a double taxation treaty between OECD-member states with no reservation to the content or applicability of the OECD Model Tax Convention.

Second, I want to look at another OECD-member state, but one which has reserved the right to tax royalties as source, and therefore differ in the level of adherence to the OECD Model Tax Convention. There are ten states in the second category which have reserved themselves from paragraph 1 of Article 12, and thus do not agree with the OECD provision that royalties should not be taxed in the source country. Norway has a double taxation agreement with all of these ten countries. Five of the countries with full reservations to Article 12 are located in Europe, and out of the remaining countries, four have been classified as having a very high level of development according to the 2013 Human Development Index (UNDP, 2013:152). My wish is to select a bilateral taxation agreement with an OECD-member country which differs from Norway with regards to geography, cultural ties and economic activity, in order to ensure variation in the sample. This will strengthen representativeness which was discussed in section 3.4 of Chapter 3. Arriving at a sample which represents a more diverse selection will strengthen the external validity and possibility to generalise to the population as a whole. Using the Human Development Index adjusted for inequality is one way to distinguish the level of economic and human development. Based upon this index I find that the country which differs the most from Norway in this group in terms of geography (outside of Europe), and in terms of development, is Mexico. Mexico is classified in a different category of human development than Norway, and is also located on a different continent. When considering a double taxation agreement between OECD-member states which have fully reserved themselves

from the provision of not taxing royalties at source, I will therefore look at the agreement between Norway and Mexico.

The third category of states to consider is non-OECD member states without reservations to Article 12, paragraph 1. Among the 29 non-member states which are reflected in the 2010 version of the OECD Model Tax Convention², only two countries have not reserved the right to tax royalties at source. These two countries are the United Arab Emirates and India. Ideally I would prefer to look at the case of the United Arab Emirates as it is the only country which has not made any reservations to Article 12, and which also adheres to the OECD Commentaries. However, Norway does not have a double taxation treaty with the United Arab Emirates, so the possibility of examining this type of treaty is not available. Norway does however have a taxation treaty with India, which is the agreement I will consider in this category. It must however be noted that India has made the reservation to continue to tax royalties from technical service at source. India furthermore disagrees with a number of the OECD Commentaries and is the country with the single most interference, in the sense that it disagrees with many of the definitions provided by the Commentaries (OECD, 2012: P (12)-4 – P (12)-5).

Lastly, the category of non-OECD member states which have reserved themselves from Article 12, Paragraph 1 is to be considered. Twenty-seven (27) countries have opted to fully reserve the right to continue to tax royalties at source. These countries represent a varied collection of countries in terms of economic and human development, as well as geographic location. However, as the other treaties considered thus far have been placed in the categories of very high, high and medium development, according to the Human Development Index, it would be interesting to look at a case of an agreement between a very highly developed country and a country with low human development. These countries would likely differ with regards to interests and capabilities, and will therefore provide a case worth analysing. Considering the non-OECD member countries with reservations to the Article, only two countries experience low human development. These are The Democratic Republic of Congo

2 In the 2010 version of the OECD Model Tax Convention 31 non-member countries have given inputs. However, as Israel and Estonia became OECD members later in 2010, their positions are considered along with the rest of the member countries for the purpose of this study.

and the Ivory Coast. As Norway does not have a double taxation agreement with The DRC, the agreement which will be considered in this category is the one between Norway and the Ivory Coast.

Thus far this section has outlined the reasoning for choosing the agreements that Norway has conducted with each the four categories of countries represented in table 6.1. Ideally it would then be possible to use the same countries to conduct analysis of the agreements with the remaining combinations of countries. However, this becomes difficult as not all countries have the relevant taxation agreements with each other. The rest of this section will briefly outline the remaining treaties which will be analysed.

First, I would like to consider an agreement between an OECD-member state with reservations, and an OECD non-member without reservations. Here, it is possible to use the same countries as above, because India and Mexico have a double taxation treaty with each other which will be considered.

Second, as an OECD non-member state without full reservations India does not have an agreement with the Ivory Coast. In fact, the Ivory Coast has remarkably few double taxation agreements, only 10 agreements in total (UNCTAD, 2011: 1). However, India does have an agreement with Vietnam, which also is an OECD non-member state with full reservations to Article 12, paragraph 1. Therefore, this agreement between India and Vietnam will be considered.

Third, in considering the combination of an OECD-member state with reservations and an OECD non-member with reservations, it is not possible to use the same countries because again, the Ivory Coast does not have any agreements which fall within this category. However, using the same country from above, Vietnam does have an agreement with an OECD-member which has fully reserved itself from Paragraph 1 of Article 12, namely Australia. This agreement will be considered.

The seven bilateral taxation treaties which will be considered have now been presented. The selection of treaties to be analysed in greater detail have been based upon the categories which were developed in the previous chapter on reservations, availability and accessibility of taxation treaties, as well as the ability to understand the content of these agreement texts. The framework for developing categories of states was adopted from the reservation picture from Chapter 5 and allows for variation within the sample, which will strengthen the representativeness of the analysis and the possibility of generalising results. In addition, the diversification of the sample will allow for a better ability to answer the research question, which addresses why countries from all over the world adhere to the Model Tax Convention's principle of taxing royalties in the state of residence. Within the phrasing “all over the world” lies an intention of discovering why countries with and without influence over the content of the Model Tax Convention, and with different interests, demands and preferences for taxation standards, choose or do not choose to adhere to the propositions of the OECD. The dyads of countries which will be analysed below are: Norway-Nordic countries, Norway-Mexico, Norway-India, Norway-Ivory Coast, India-Mexico, India-Vietnam and Vietnam-Australia. I now turn to examining these bilateral taxation treaties in greater detail.

6.4 Analysis of Treaties

This section will look at the selected bilateral agreements outlined above. The aim of this analysis is to determine to which degree bilateral taxation agreements between various categories of countries follow the recommendations that the OECD Model Tax Convention provides, in other words; the level of adherence to the Model Tax Convention. Section 6.6 and 6.7 will turn to analysing the explanations behind adherence by looking at the independent variables and determine whether they have the power to explain adherence to the Model Tax Convention.

The analysis will look mainly at the first paragraph which states whether the agreements adhere to the OECD principle of taxing royalties in the state of residence. It is Paragraph 1 of Article 12 which outlines the OECD principle of exclusive taxation rights of royalties to the

state of residence, which is of particular importance to answer the research question. In order to consider the issue of taxation of royalties in its context, and to get a more comprehensive view of adherence, the remaining aspects of Article 12 will be briefly considered.

6.4.1 Bilateral Taxation Treaty between Norway and the Nordic countries

None of the Nordic Countries have made any reservations towards Article 12 of the OECD Model Tax Convention whatsoever. Neither have any of the countries made any comments or explicit positions on the OECD Commentaries of the Convention text. The taxation treaty is therefore expected to follow the propositions outlined by the OECD, and adhere to the principle of taxing royalties in the state of residence only.

Article 12 of the agreement is a direct copy of the OECD Model Tax Convention. No words or principles have been changed, but paragraph 2 of the Model Tax Convention, which defines the term royalties was excluded from the agreement text in 2008 (Norwegian Ministry of Finance, 2008). There is no reason to believe that this exclusion was done for any other reason than confirming that there is consensus on the definition of royalties. After the amendments made to the agreement in 2008, a list of justifications and explanations of changes were made, and the exclusion of paragraph 2 is not included in this list, confirming that the removal of this paragraph was trivial.

The double taxation agreement is thus in complete unison with the OECD Model Tax Convention. The treaty follows the expectations in that no country had made reservations so they were expected to adhere to the Model Tax Convention. The treaty is thus aligned with expectations which strengthen the model.

6.4.2 Bilateral Taxation Treaty between Norway and Mexico

While Norway is a member of the OECD with no reservation to the principle of taxing royalties in the state of residence, Mexico is also a member of the OECD but has reserved the right to tax royalties in the source country. As the OECD itself encourages countries to respect reservations made, it is expected that the taxation treaty between these two states will not adhere to the Model Tax Convention, but rather allow for taxation of royalties in the source state.

The content of Article 12 is closely related to the OECD Model Tax Convention, and the first paragraph is nearly the same as the OECD proposition, stating that royalties may be taxed in the state of residence. However, a second paragraph is added which determines that the royalty can also be taxed in the source country, as long as the taxation of the royalty does not exceed 10% of the royalty's gross value.

The Article otherwise follows the OECD Model Tax Convention closely, adhering to the same definition of what constitutes a royalty. A few minor additions are included in the double taxation agreement to define which circumstances must be fulfilled in order to claim that a royalty derives from any given country. However, these are minor additions which only function as clarifications of the Article text, and are for the most part taken from the OECD Commentaries. The exception to this, is paragraph 7 which opens up for bilateral negotiations between the tax authorities in relation to individual cases, and paragraph 8 which opens up for negotiations in cases where the royalty may be suspected to exceed the arm-length principle i.e. the price of the royalty exceed the marked value and thus initiate suspicions of tax avoidance. In these cases, tax authorities in both states should consult on the issue.

Article 12 of the double taxation agreement between Norway and Mexico thus adheres to the OECD Model Tax Convention to a certain extent. The overarching principle is that royalties are to be taxed in the state of residence, but with an extra addendum added which clearly opens up for limited royalty taxation in the source state. A 10% tax can be deducted in the source country on income from royalties. Taxation rates on royalties usually mirror corporate taxation rates which were at a global average of 24% in 2013 (KPMG, 2014), meaning states of residence has the opportunity to tax slightly more than the source country (14% if the

global average is used as an indicator). As Norway has not used the opportunity to reserve itself from this paragraph in the OECD Model Tax Convention, while Mexico has reserved itself, it is likely that paragraph 2 has been added at the request of Mexico. It is reasonable to assume that bilateral negotiations have resulted in the 10% ceiling on royalty taxation at source as a compromise.

Mexico's reservation was therefore respected by Norway in these negotiations and, as expected, the taxation treaty does not adhere to the Model Tax Convention.

6.4.3 Bilateral Taxation Treaty between Norway and India

India is one of two countries which fall into the category of non-OECD members which have opted not to fully reserve themselves from Article 12, paragraph 1. However, as can be seen in table 5.2, India is the only country who has made a limited reservation to this paragraph. Examining the nature of this reservation, it states that “India reserves the right to: tax royalties and fees for technical service at source (...)” (OECD, 2012: P (12)-1). Based upon the lack of reservations towards taxing royalties in the state of residence, it is expected that the taxation treaty will adhere to the Model Tax Convention. However, if the smaller reservation is followed, one may expect that the taxation treaty will allow for royalties and fees for technical services to be taxed in the source country.

The first paragraph of the taxation treaty follows the first paragraph of the OECD Model Tax Convention, and states that royalties should be taxed in the state of residence. However, paragraph 2 provides an addition that directly reflects the reservation made by India, and states that royalties or fees from technical service can also be taxed in the source country, as long as the source taxation does not exceed 10% of the gross value of the royalty payment (Norwegian Ministry of Finance, 2011: 7).

The remaining paragraphs of Article 12 in the agreement is copied from the OECD Model Tax Convention, but with a couple of added paragraphs which explicitly defines and outlines the conditions for taxing royalties and fees for technical service in the source country.

It can be deduced that Norway has in these negotiations accepted India's reservation against taxing royalties and fees for technical service in the state of residence, and accepted that this type of royalty also be taxed in the source country. During the negotiations a compromise has been made that outlines that source taxation of royalties and fees for technical service be limited to 10%. The position put forward in the OECD document is reflected almost word for word in this bilateral agreement. The taxation treaty therefore adheres to taxing royalties in the state of residence, but scores slightly lower on the adherence variable due to the exemption for technical fees and royalties.

6.4.4 Bilateral Taxation Treaty between Norway and the Ivory Coast

The Ivory Coast has fully reserved itself from paragraph 1 of Article 12 in the OECD Model Tax Convention. However, the Ivory Coast only reserved itself from this particular paragraph in 2003 (OECD, 2012: P (12)-6), and the bilateral double taxation agreement between Norway and the Ivory Coast was signed in 1978, and has not been updated since. Since neither Norway nor the Ivory Coast had made any reservation towards taxing royalties in the state of residence in 1978, it is expected that the taxation treaty will adhere to the Model Tax Convention.

The first sentence of paragraph 1 in Article 12 in the bilateral agreement states that royalties may be taxed in the state of residence. However, paragraph 1 continues to outline important exceptions to this, by determining that all royalties related to the use of any natural resources in the source country should only be taxed in this source country.

Furthermore, paragraph 2 expands on the general rule of the taxation of royalties in the state of residence, by noting that royalties can in fact also be taxed in the source country, but this taxation is capped at 16% of the gross value of the royalty. Thus, the taxation of royalties is in practical terms split between the source country and the country of residence. The average global taxation rate is around 24% percent (KPMG, 2014) and if this is any indicator, the source country actually has the opportunity to collect the largest share of taxation income. The rest of the Article follows the definitions and terms laid out by the OECD Model Tax

Convention, with only one additional paragraph which specifies how to define the country of residence and the source country.

Even though the Ivory Coast did not reserve itself from the OECD principle of taxing royalties in the country of residence before 2003, the bilateral agreement nevertheless seems to reflect the view that royalties should also be taxable in the source country. There are not exclusive taxation rights on royalties in neither the source nor the residence country, but sharing this right seems to reflect a compromise between the OECD perspective and the view voiced by many developing countries that source countries should be allowed to tax income from royalties.

The taxation treaty between Norway and the Ivory Coast thus break with expectations as they presented themselves in 1978, but follow current expectations because the Ivory Coast has made a reservation to tax royalties at source after the taxation treaty was concluded. Adherence to the Model Tax Convention is therefore low.

Section 6.4.5 to 6.4.7 will now turn to taxation treaties concluded without a typical OECD member state, which in the cases above has been Norway.

6.4.5 Bilateral Taxation Treaty between India and Mexico

As already stated, India is one out of only two non-OECD countries that has not fully reserved itself from Paragraph 1 of Article 12 in the OECD Model Tax Convention. However, it has insisted on including fees for technical service in the definition of royalties, and reserved the right to tax these fees in the source country. Mexico has fully reserved itself from the Paragraph in question. Expectations are that this bilateral taxation treaty will have a low level of adherence to the Model Tax Convention despite the fact that only one party has fully reserved the right to tax royalties at source.

The first Paragraph of the bilateral agreement states that both royalties and fees for technical service are to be taxed in the state of residence, which is consistent with the OECD Model

Tax Convention. However, the second Paragraph opens up for taxation in the source country of royalties and fees for technical service, but with a cap on 10% taxation. Thus, the agreement provides the basis for sharing taxation rights for royalties and fees for technical service.

Furthermore, Mexico, which has fully reserved the right to tax royalties at source, has given up this principle in the agreement with India. Mexico has accepted India's proposition to tax royalties and fees for technical service only at source, while other royalties are to be taxed in the state of residence only which is in accordance with the Model Tax Convention.

Otherwise, the Article in the bilateral agreement follows the OECD Model Tax Convention, but it provides some additional paragraphs which define the terms for taxing fees for technical service. These paragraphs follow the same terms that the OECD Model Tax Convention provides for taxing royalties. Adherence to the Model Tax Convention is therefore relatively low, but not as low as expected as it is only royalties and fees for technical service that are to be taxed in the source state.

6.4.6 Bilateral Taxation Treaty between India and Vietnam

India has not fully reserved the right to tax royalties at source, but has limited this reservation to only regard royalties and fees for technical service. Vietnam, on the other hand, has fully reserved itself from the OECD principle of exclusive taxation rights of royalties to the state of residence. Based upon these preferences, it is expected that the taxation treaty between these two countries will not adhere to the Model Tax Convention.

Although India has insisted on including fees for technical service in all of the preceding bilateral taxation agreements, this is not explicitly mentioned in the agreement between India and Vietnam. The first Paragraph of Article 12 in the bilateral taxation agreement between India and Vietnam gives the state of residence the right to tax royalties. However, the second paragraph states that also the source country is entitled to tax royalties with up to 10 %.

The remaining parts of Article 12 of the agreement are consistent with the OECD Model Tax Convention, and follow the same definitions of royalties as the OECD provides. The only addition to the agreement is a paragraph which defines what constitutes a source country and what defines a country of residence.

It is curious that this particular agreement made by India does not include any particular mention of fees for technical service, as do other agreements made by India considered here. Especially because this bilateral agreement does not differentiate itself in terms of the date of signing. The other agreements that India has signed with Norway and Mexico were concluded in 2011 and 1961 respectively, while the agreement with Vietnam was concluded in 1995. In light of this, there is no reason to believe that India's preferences have changed over time with regards to including fees for technical service into the agreement, but rather it may have something to do with the party of the agreement. Perhaps, this anomaly is related to Vietnam being a country with a level of development which differs from the other bilateral agreements considered here. Otherwise, it may be that India considers the inclusion of a 10% tax on royalties at source to satisfy their position. It may do so in terms of royalties for technical service, but this does not change the fact that the agreement does not address the issue of taxing fees for technical service.

The agreement provides the opportunity for shared taxation between the two states, as long as the tax at source does not exceed 10%. The expectation of non-adherence is thus not completely fulfilled, but the level of adherence to the Model Tax Convention is low.

6.4.7 Bilateral Taxation Treaty between Vietnam and Australia

Both Australia as an OECD-member and Vietnam as a non-OECD member have fully reserved themselves from Paragraph 1 of Article 12 of the OECD Model Tax Convention. This means that none of the countries should be expected to adhere to the principle of taxing royalties in the state of residence.

However, the first paragraph of Article 12 in the bilateral taxation agreement does state that royalties may be taxed in the state of residence. But as have been observed in previous taxation treaties, the second paragraph states that royalties may also be taxable in the source country, as long as the tax does not exceed 10% and thus provides the basis for shared taxation of royalties.

The bilateral agreement also expands the definition of royalties compared with the definition that the OECD provides in the Model Tax Convention. But it must be noted that the extended definition does not interfere with the OECD's definition because it merely incorporates the extended definitions outlined in the OECD Commentaries into the actual agreement text. Thus, the agreement is consistent with the OECD Model Tax Convention with regards to the remaining parts of Article 12.

As with the taxation treaty between India and Vietnam, this taxation treaty between Vietnam and Australia has a low level of adherence to the Model Tax Convention. Adherence is however not as low as one might have expected given that both countries have reserved the right to tax royalties at source.

6.5 General trends

With regards to the bilateral taxation treaties considered, in general there seems to be a trend towards not following the OECD Model Tax Convention, Article 12, Paragraph 1 with regards to taxing royalties in the state of residence only. Only the agreement between the Nordic countries fully adheres to the OECD Model Tax Convention, and states that royalties are to be taxed *only* in the state of residence. All other bilateral agreements have included a similar paragraph into the agreement. However, while the OECD Model Tax Convention use the phrasing: “*shall* be taxable *only* in that other State” (OECD, 2012: M-34), all the agreements (excluding the one between Norway and the Nordic countries) use the phrasing: “*may* be taxed in that other State”. That other State, in both cases refers to the country of

residence. The bilateral agreements thus use a weaker language than do the OECD Model Tax Convention, and rather follow the UN Model Convention which also uses the word may (UN, 2011: 18). Furthermore, all the bilateral agreements include a second paragraph which states that royalties may also be taxed in the source country. The majority of the bilateral taxation treaties cap the taxation of royalties at source at 10%. The exceptions to this cap at 10% are the agreement between Norway and the Nordic countries, and the agreement between Norway and the Ivory Coast. The agreement between Norway and the Ivory Coast cap taxation of royalties at source to 16% for most royalties, and provide exclusive royalty taxation rights at source for royalties related to natural resources. Shared rights to taxation of royalties thus seem to be the main trend in bilateral taxation agreements. In other words, the main observation is a low level of adherence to the Model Tax Convention.

It is interesting to note that this general trend of using a 10% cap on taxation of royalties at source seems to be a trend derived from an unofficial consensus amongst the states considered here. The OECD Model Tax Convention does not recommend taxation of royalties at source whatsoever, while the UN Model Convention does recommend shared taxation of royalties. However, the UN Model Convention does not provide a recommendation of capping this tax at 10%, but rather leaves the level of taxation to be determined by the countries in negotiations.

In general, non-OECD members tend to reserve themselves from exclusive taxation rights on royalties in the state of residence as found in Chapter 5. This is reflected in the findings from the selected bilateral agreements where the OECD principle of exclusive taxation rights in the country of residence is adhered to only between OECD countries that have not made any reservations to Article 12 of the OECD Model Tax Convention. The remaining bilateral taxation agreements have a low level of adherence to the Model Tax Convention, and rather follow the principle of shared taxation rights on profits arising from royalty payments.

So far this chapter has focused on the selection of the sample for analysis and the level of adherence observed in the bilateral taxation treaties in this sample. It has been observed that adherence to the Model Tax Convention is relatively low as a general trend. But countries do not divert completely from the propositions of the OECD in the sense that countries do adhere

to having some taxation of royalties in the state of residence, although not exclusively as the OECD recommends. The remaining part of the chapter will turn to the independent variables and try to answer the research question by finding the underlying reasons for the trends of adherence discovered above. What will be analysed in the sections to follow will be the explanation behind the low level of adherence to the Model Tax Convention by using the independent variables of this research project.

6.6 Explaining Adherence

The theoretical background of moral and cognitive legitimacy, self-interests and negotiation power was outlined in detail in chapter two, and is the basis for the independent variables in this thesis. This section will discuss which variables provide viable explanations for adherence to the Model Tax Convention. Because the taxation treaty is a product of the relationship between the states in question, no definite conclusions can be drawn upon the perceptions of legitimacy of each state individually from these treaties. The states have discussed, compromised and finally agreed upon certain policies. This discussion will therefore focus on the taxation treaties themselves, as well as how states seem to act in relation to their reservations investigated in the previous chapter. These reservations express the opinion of individual states towards the OECD principle of exclusive taxation rights to the state of residence and here I discuss how these preferences are affected and acted upon in taxation treaties. As in the previous empirical chapters, the discussions below in this section and the next will justify the conclusions made in order to increase the transparency in this thesis, in line with Gerring's (2005) criteria for good research.

Moral legitimacy represents calculations made by countries on whether the OECD and its policies represent the “right thing to do.” Chapter 5 found evidence to support the claim that moral legitimacy has some power to explain why states issue reservations to the Model Tax Convention.

It is difficult to gather evidence of moral considerations directly from the taxation treaties because these naturally do not contain reflections of the morality of OECD's principles. However, evidence of moral legitimacy in the case of bilateral taxation treaties could be

indicated through negotiating parties giving special rights or concessions to states which are considered less developed than oneself. One example of moral legitimacy would be if countries rewarded source countries with a variation in the percentage of taxation dependent on the level of economic development. Looking at the taxation treaty between Norway and the Ivory Coast, some evidence of how moral legitimacy has indirectly influenced the outcome of taxation treaties can be found. This treaty diverges from the trend of a 10% cap of royalties in the source country, and sets the cap at 16%. The treaty also gives extensive benefits to the source country when it comes to production based on natural resources where there is a royalty attached. Because the Ivory Coast is a typical source country and Norway has not made a reservation, it is evident that this cap has been made for the benefit of the Ivory Coast. In addition, the Ivory Coast is the least developed country considered in the analysis above and the country receiving the most favourable treatment, which raise the question of whether this is done for moral reasons. Norway may have felt during negotiations that “the right thing to do” was to grant the Ivory Coast some additional beneficial treatment.

The interview at the Norwegian Ministry of Finance revealed that: “We are generally more accommodating to taxing royalties at source in developing countries as opposed to developed countries. The total picture of the interactions between Norway and a developing country will differ from our relations with for instance Germany or the Netherlands” (Appendix 2, 2014 [interview]). This statement supports the findings above that, at least in the case of Norway, morality may influence the outcome of negotiations in the sense that developing countries may receive special treatment due to their status as a developing country.

Another case where moral legitimacy seems to matter, although a less obvious case, is the taxation treaty between India and Vietnam. While Vietnam prefers not to tax royalties exclusively in the state of residence, India has a preference for taxing only royalties from technical service also in the source country. However, the agreement provides taxation right to the source country up to 10%. Although this does not go directly against India's preferences, it is the views of Vietnam which are explicitly reflected in the taxation treaty. Although India is a much more powerful economy (as will be expanded upon below), Vietnam has received concessions from India so that Vietnam's preferences are the most visible in the taxation treaty. This may also signal moral considerations in that India refrains

from insisting on having their concrete preferences followed in order to provide benefits to a less developed country than themselves.

These examples show that moral legitimacy seems to be a factor which can explain the level of adherence to the Model Tax Convention in certain cases. The data material does not provide conclusive evidence that moral legitimacy is the only factor of interests, but the cases referred to here, and the statement provided in the interview, demonstrates the viability of moral legitimacy as a possible explanation.

Cognitive legitimacy is legitimacy based upon decisions taken without deliberate calculations, as a result of countries taking the direction of these decisions for granted. Chapter 5 analysed the reservation picture and found that reservations represent a sign that countries do not take the Model Tax Convention for granted. Rather, the reservations are a sign that countries deliberately evaluate the propositions of the Model Tax Convention, and if they disagree with the propositions therein they make reservations.

When looking at the bilateral taxation treaties there seems to be some evidence in support of cognitive legitimacy as an explanatory factor for decisions that states make. In each case explored here where one country has made a reservation, this reservation has been taken into account and is reflected in the bilateral taxation treaty. In the vast majority of taxation treaties, it seems like one country accepts the reservations made by the other country. This leads most treaties to share taxation of royalties and cap the tax at 10% in the source country. The repeated appearance of a 10% cap reflects some kind of unwritten consensus that this is an appropriate level of taxation for royalties in the source country. Also, the repeated appearance of the 10% cap seems to reflect that this compromise is accepted without deliberate calculations, thus signalling an element of cognitive legitimacy. The employee at the Norwegian Ministry of Finance was asked to reflect on the fact that the 10% cap on royalties in the source state seems to be the norm, and claimed that “The fact that countries end up with a 10% cap is because it is a natural compromise” (Appendix 2, 2014[interview]). Apart from this statement, the informant did not have any further insights into why taxation treaties set royalty taxation rates at 10% in the source state, which supports the impression of the 10% cap as a cognitive decision made by states.

However, it is not likely that negotiators have accepted a 10% cap on taxation of royalties in the source country without discussions with the opposing party. Most likely, negotiations have dwelled at this particular proposition in the Model Tax Convention, and the parties have ended up with a compromise at 10%. Due to this fact, it is not particularly satisfying to conclude that cognitive legitimacy is a good explanation for the level of adherence.

Self-interests as a variable rests upon the assumption that states act to maximise their own benefits. When it comes to the bilateral taxation treaties we are looking at the result of communication between two states which may have different views on the benefits that the Model Tax Convention has for themselves. Still, despite of these differences in interests, the parties have come together and agreed upon a taxation treaty which they intend to enforce on actors operating across the two economies.

There is a general trend of not adhering to the OECD principle of taxing royalties exclusively in the state of residence. Instead, a 10% tax on royalties in the source states is usually allowed in the taxation treaty. In terms of self-interests this signals that states do not expect the OECD proposition to be of benefit. They seem to weigh not adhering to the OECD principle higher than adhering for the sake of respecting the higher goals and aims of the OECD as an organisation. Even states which adhere to the Model Tax Convention in terms of not issuing a reservation put their preferences aside in order to respect the reservation of another state which lowers the overall level of adherence.

Chapter 5 showed that the decision to make a reservation or not towards the Model Tax Convention is based primarily upon the expected benefits that states stand to gain from making a reservation or not making a reservation. However, when the process of evaluating the Model Tax Convention itself is completed by individual states, and state start to negotiate with each other over what bilateral taxation treaties should look like, this thesis finds no evidence that self-interests is a major part of the taxation treaties. It is likely that states will try to promote their own self-interests in the negotiation process. However, the actual outcome presented by the taxation treaties themselves provide evidence that compromise seem to be

the most important trait, as demonstrated by the 10% compromise observed in the majority of taxation treaties considered.

Negotiation power is in the theoretical framework divided into three aspects, namely aggregate structural power, issue-specific structural power and behavioural power. However, issue-specific power is considered the most important aspect of negotiation strength for the purpose of this thesis, and will be defined in terms of GDP (measured in current US \$) as relative economic power is considered the determining factor in negotiations over taxation treaties. The reason why I use GDP as a measurement is because states negotiating with each other will be concerned primarily with the issue of how important the economy of the opposing state is to themselves. If a small economic power is negotiating with a large economic power, then the relationship will be influenced more by this fact than, for example, the size of the economy relative the size of the population (GDP per capita). In order to be able to determine the relative economic power of each party to the negotiations, each taxation treaty must be considered in turn. I will do so by comparing GDP for the parties negotiating. I have decided to use the indicator for the year that the taxation treaty was signed only, because I consider it representable for the time period which was used negotiating the taxation treaty and it is unlikely that the relative economic power will have shifted significantly over the negotiation process. Note that the figures have different scales dependent on the size of the economies in question in each case.

Norway and the Nordic Countries

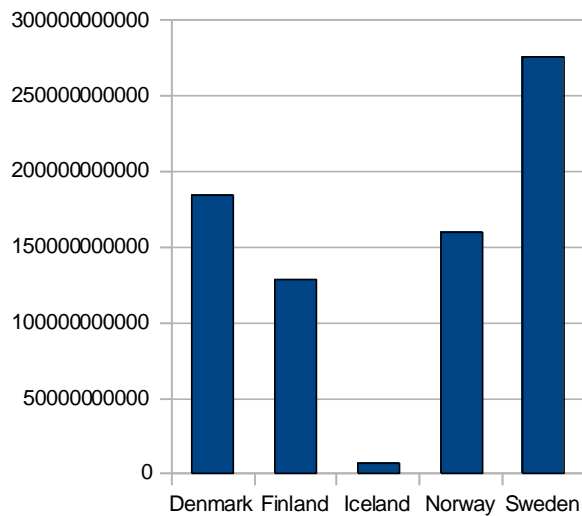


Figure 6.1: GDP Nordic Countries, 1996

making conclusions about the importance of economic capabilities in this case.

Figure 6.1 indicates that the economic situation of the Nordic countries varies, with Sweden being the largest economy and Iceland being the absolute smallest in 1996. Despite the difference in the size of economies, the Nordic countries have the same preferences on policies following the reservations to the Model Tax Convention (no reservations; adhere to the OECD principle). Based upon the similarities in preferences then, there is no background for

Norway and Mexico

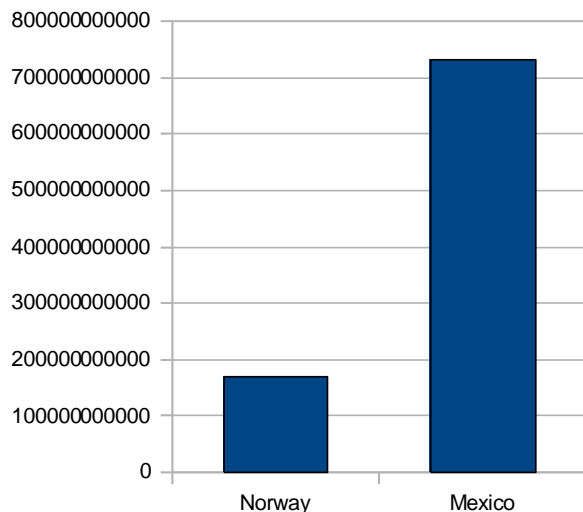
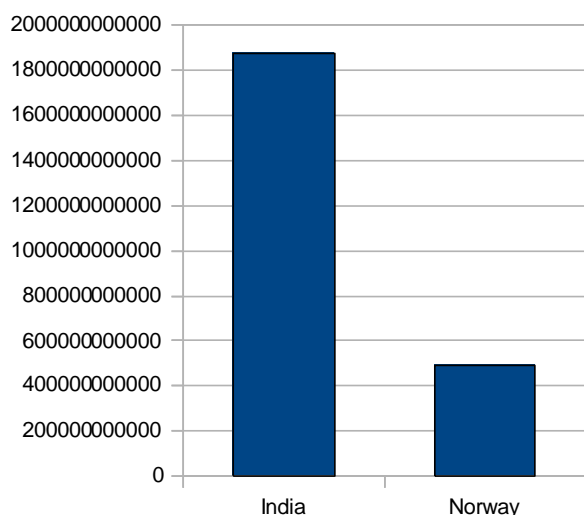


Figure 6.2: GDP Norway and Mexico, 2001

The size of Mexico's economy was considerably larger than Norway's in 2001. While Norway prefers taxing royalties in the state of residence, Mexico prefers taxing at least part of the royalty in the source country. If economic capabilities were the determining factor, then we would expect Mexico as a bigger economy to affect the content of the taxation treaty. As the treaty opens up for shared taxation rights on royalties, this expectation is borne out in reality.

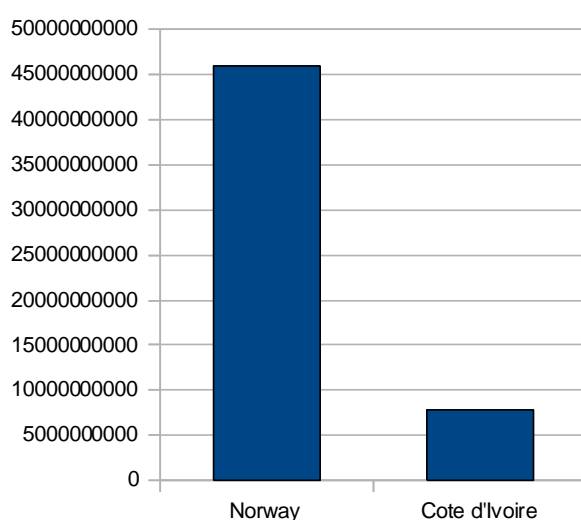
Norway and India



In 2011 there was a large difference between Norway's and India's economic power. Relative to each other, India held a considerably higher level of economic strength than Norway. If negotiation power had the power to explain adherence, India's preferences of taxing royalties exclusively in the state of residence - with an exception for royalties and fees for technical service would have been followed in the bilateral taxation treaty. The taxation treaty follows

Figure 6.3: GDP Norway and India, 2011 India's preferences in this manner. Norway also adheres to the principle of exclusive taxation rights on royalties to the state of residence, but does not treat royalties and fees for technical services differently to other types of royalties. India's greater economic capabilities seem to contribute to its ability to achieve its preferences in negotiations.

Norway and the Ivory Coast



During the negotiations between Norway and the Ivory Coast in 1978 there was a vast disparity between the economic power capabilities of the two countries, where Norway had a much higher level of economic strength than the Ivory Coast. If negotiation power was a determining factor of explanation then, we would expect Norway's preferences to dominate the level of adherence to the Model Tax Convention reflected in the taxation treaty. This is, however, not the case.

Figure 6.4: GDP Norway and the Ivory Coast, 1978 Norway's preference of taxing

royalties exclusively in the state of residence is not adhered to in the taxation treaty. Rather, shared taxation of royalties and exclusive taxation rights to the source state on royalties from natural resources is established through the taxation treaty. It can be deduced that negotiation power does not influence the outcome of the negotiations in this case.

India and Mexico

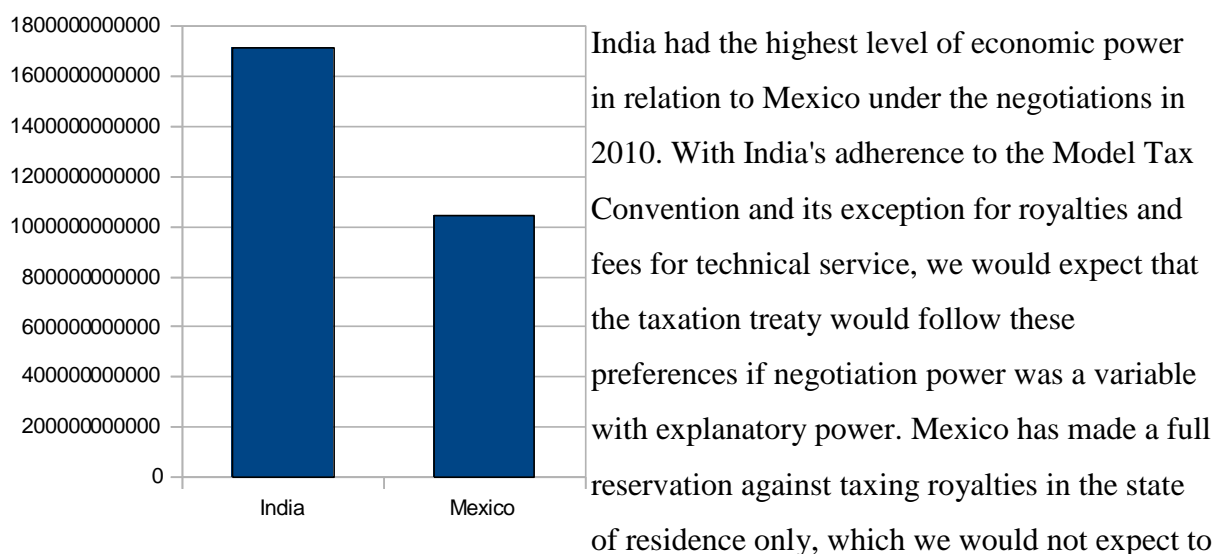
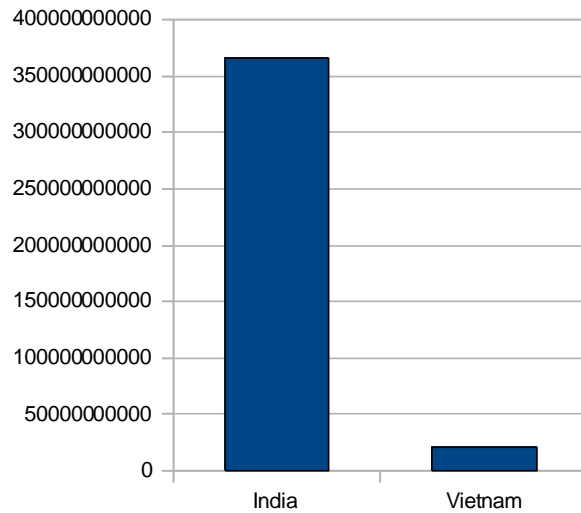


Figure 6.5: GDP India and Mexico, 2010 be followed due to Mexico's lower economic capabilities. These expectations are followed up as the taxation treaty reflects only the limited reservation that India has made. The treaty states that only royalties and fees for technical service may be taxed in the source country, while other royalties are to be taxed in the country of residence. This is evidence that India's economic power seems to have influenced the outcome of negotiations.

India and Vietnam



India had a considerably higher level of economic power compared to Vietnam in 1995.

If negotiation power has explanatory power we would expect India which has made a limited reservation to the Model Tax Convention to determine the outcome of negotiations.

However, the taxation treaty states that taxation of all royalties are to be shared between the state of residence and the source state, which is the preference of Vietnam, which has made a full

Figure 6.6: GDP India and Vietnam, 1995 reservation to the proposition outlining this principle in the Model Tax Convention. Although India's reservation is covered by the taxation treaty, the proposition goes further and satisfies Vietnam's preferences. Negotiation power thus does not seem to have determined the outcome.



Figure 6.7: GDP Vietnam and Australia, 2002 of Vietnam. It is therefore difficult to conclude that negotiation power has influenced the outcome of negotiations, as the two parties are in agreement on how to distribute taxation of royalties.

From the analysis of negotiation power above, it seems that, to a certain extent, economic capabilities have the power to explain the level of adherence to the Model Tax Convention reflected in the bilateral taxation treaties. The taxation treaties between the Nordic countries, and Vietnam and Australia do not provide conclusive proof in either direction. The treaties between Norway and the Ivory Coast, and India and Vietnam seem to suggest that higher negotiation power does not determine the outcome of negotiations. However the taxation treaties between Norway and Mexico, Norway and India, and India and Mexico show evidence of negotiation power being a decisive factor for determining the outcome of negotiations, and thus also to which extent the taxation treaty adheres to the Model Tax Convention. The data material is thus divided. However, what should be noted is that in cases where preferences are the same, one would not readily expect to find conclusive evidence, as it would not have been necessary for disagreements to be resolved. This summary is presented in table 6.2.

Economic capabilities matter	Same Preferences/ Inconclusive	Economic capabilities does not matter
Norway-Mexico	Nordic countries	Norway-Ivory Coast
Norway-India	Vietnam-Australia	India-Vietnam
India-Mexico		

Table 6.2: Summary of Analysis of Negotiation Power

Table 6.2 demonstrates that the data material provides mixed evidence. However, if we discount the cases where full agreement over preferences were present, then the majority of cases indicate that economic power as an indicator of negotiation power does seem to matter with regards to how negotiations over taxation treaties are concluded. The state with the highest economic capabilities has the most power over the negotiation outcome.

6.7 Discussion of Explanations

The analysis of the independent variables shows that self-interests do not seem to adequately explain the outcome of bilateral taxation treaties. This is not to say that self-interests are not important altogether; it has been demonstrated in the previous chapter that they are, but by the time states start to negotiate over the content of taxation treaties, the data material used in this thesis cannot support self-interests to be an important factor of explanation.

Cognitive legitimacy seems to explain certain aspects of the negotiations between states over taxation treaties. Rather than deliberate calculations over which rate of taxation of royalties is appropriate, it seems that states accept reservations made by other states, and furthermore accept a cap of taxation rates at 10% without much contemplation. Of course, it is impossible to say exactly what has happened around the negotiation table, but the repeated appearance of the 10% taxation rate indicates that states may accept this level of taxation rates cognitively. However, it is difficult to determine the certainty of this observation.

Moral legitimacy seems to be a viable explanation to a certain extent. In the taxation treaty

between a very developed country and the least developed country considered in this analysis, morality trumps other factors as demonstrated by the taxation treaty between Norway and the Ivory Coast. Norway, which has the largest economy, seems to put their preferences aside in order to fulfil the preferences of the Ivory Coast. The analysis of the negotiation power of states also identified this particular taxation treaty as the only odd treaty where economic power did not decisively influence the outcome of negotiations. This observation adds to the notion that morality played a part in determining the outcome of negotiations. The taxation treaty between Vietnam and India is another case where India as the greatest power has given up their preferences in order to comply with Vietnam's wishes over the content of taxation treaties. The interview with the representative from the Norwegian Ministry of Finance further confirmed that states, at least in the case of Norway, differentiate treatment between developed countries and developing countries, where the less developed countries are more likely to receive favourable treatment. Thus, moral legitimacy appears to be a variable which explains the level of adherence in certain cases.

Negotiation power seems to be a convincing explanation for the level of adherence to the Model Tax Convention observed in the bilateral taxation treaties. The taxation treaties between Norway and Mexico, Norway and India, and India and Mexico provide evidence that negotiation power is able to explain the outcome of negotiations. These treaties show how the country with the largest economy, and thus the greatest economic power, is the country whose preferences are adhered to in the taxation treaty. The taxation treaties between Norway and the Ivory Coast, and India and Vietnam are the only treaties where economic capabilities do not explain the outcome of negotiations. The remaining taxation treaties analysed in this chapter provide mixed evidence where it is uncertain whether economic capabilities play a role in determining the outcome, because the states involved in negotiations had the same preferences at the outset.

Table 6.2 provides a summary of the analysis of which taxation treaties indicated negotiation power as an important factor for determining the outcome, and thus determining the level of adherence to the Model Tax Convention. Table 6.3 combines the results with the analysis of moral legitimacy as a viable explanatory factor for adherence.

Economic capabilities matter	Moral considerations matter	Same Preferences/Inconclusive
Norway-Mexico	Norway-Ivory Coast	Norway-Nordic Countries
Norway-India	India-Vietnam	Vietnam-Australia
India-Mexico		

Table 6.3: Negotiation power versus Moral Legitimacy

Table 6.3 demonstrates that the results of the analysis of which explanatory factor seems to be the most important for determining the level of adherence to the Model Tax Convention in terms of bilateral taxation treaties, is not conclusive in the sense that one variable clearly explain variance in adherence. Quantitatively, the size of state's economy, and thus the level of power in negotiations explain the result of most negotiations, but with such small margins it is not satisfactory to conclude that power is the best explanation. Rather, it seems like both explanations have some power to account for variation in adherence in different types of negotiations. It is likely that depending on the countries negotiating, the strength of their preferences and their relationship to each other, the relative power of each state and the moral perception of states influence the outcome of negotiations.

6.8 Summary

This chapter has focused on selected bilateral taxation treaties that have been concluded. Using the codings of reservations from the previous chapter, and the distinction between member countries and non-member countries of the OECD, allowed me to consider taxation treaties from different groups of countries. Although the selection of taxation treaties was strategic and selected with an intention to improve variation in the sample with regards to the dependent variable, it should be noted that the sample may not be representative for the entire population. With such a small sample bias may occur, but through transparency in the selection process and the strategic sample which derived from this process, I hope to have minimised bias to the largest possible extent. After having outlined the reasons for selecting which countries to consider in the analysis, the content of Article 12 was analysed in each bilateral taxation treaty. In general, it was discovered that the taxation treaties demonstrate a low level of adherence to the OECD principle of awarding exclusive taxation rights to the

country of residence. This has not been recognised in previous literature concerning the Model Tax Convention. Rather, it is often assumed that the Model Tax Convention is the model that countries use for taxation treaties. This is an indication that the legitimisation strategies used by the OECD (Chapter 4), which were discovered to be mainly cognitive legitimisation, has had the desired effect. Scholars dealing with taxation treaties and the OECD tend to take it for granted that the Model Tax Convention of the OECD is the primary tool for concluding taxation treaties, without recognising that in reality the level of adherence is not very high. In commemoration of the 50th anniversary of the Model Tax Convention in 2008, the OECD hosted a conference of which Ault notes that, “Both the level of participation and the geographical diversity represented at the conference would seem concrete evidence of the perceived importance of the role of the OECD in developing international tax norms” (Ault, 2009: 757). He bases his study upon the importance of the OECD in international tax matters. Similarly, Lesage and Van de Graaf have written an entire essay that aims to show how the OECD is thriving internationally in the issue-area of taxation. They claim that “The OECD has long been the linchpin of international cooperation on tax matters” (2013: 84). I will not argue against the claim that the OECD plays an important role in the matter of taxation in the international sphere, but the purpose of referring to these academic works is to show that there might be a lack of critical observation on the level of adherence when it comes to the OECD and the Model Tax Convention. In this regard, it can be concluded that OECD's cognitive legitimisation strategy has been successful in convincing scholars of international taxation of the prominence of the Model Tax Convention, while states act in a different manner.

Instead of adhering to the OECD principle of taxing royalties in the state of residence, shared taxation of royalties is the main trend in the taxation treaties considered in this chapter. In most cases, taxation is split between the source country and the country of residence, and a cap of 10% at source is the norm in the treaties considered.

The analysis of the explanatory factors behind this trend found evidence of several factors influencing the decision to accept reservations in the bilateral taxation treaties. Self-interests do not seem to be a factor with any explanatory power on the level of adherence in the taxation treaties. In the previous chapter, it was found that self-interests account for variation in adherence between OECD member states and OECD non-member states. This explanation

for variance has already been taken into account when considering the taxation treaties concluded, because these treaties take the reservations into consideration during the negotiations. However, the taxation treaties themselves do not seem to reflect self-interests to be factors of importance to the outcome further than respecting the reservations. Cognitive considerations seem to influence the level of adherence to a certain extent. The 10% cap on taxation of royalties in the source state is evidence pointing towards this unofficial standard being taken for granted as a recognised compromise on what taxation rate to land upon when there is disagreement over where to tax royalties.

Moral considerations are taken into account in the taxation treaty between Norway and the Ivory Coast, and between India and Vietnam, where respectively Norway and India foregoes their preferences of taxing royalties in the state of residence and, rather, grants extensive taxation rights to the country less developed than themselves. The interview conducted also confirms that, at least in the case of Norwegian taxation treaty negotiations, special considerations might be taken in order to provide a beneficial treaty to less developed countries. The explanation of adherence related to the power of each state, has also been demonstrated to be of importance in certain taxation treaty. In the treaties between Norway and Mexico, Norway and India, and India and Mexico, the state with the highest power capabilities have had their preferences followed. Thus, the results are mixed, but moral legitimacy and negotiation power are recognised as the most important factors for explaining adherence to the Model Tax Convention.

7 Compilation of Findings and Conclusions

7.1 Introduction

This thesis set out to answer two research questions. The first question asked “how has the OECD proceeded in legitimating the Model Tax Convention?” while the second research question asked “why do countries from all over the world adhere to the OECD Model Tax Convention and its principle of exclusive right to tax royalties in states of residence?” These research questions emerged from a curiosity over the way the OECD Model Tax Convention was portrayed as the most influential model for negotiating taxation treaties in literature and among organisations working with taxation issues. After having outlined and developed the theoretical framework, the analytical model and the research design in chapters 2-3, chapters 4-6 analysed the two research questions using the method of pattern-matching to find evidence of theoretical explanations in the empirical material. While chapter 4 focused on answering the first research question, chapters 5 and 6 aimed to answer the second research question. This chapter will summarise the findings and discuss the links between the findings in empirical chapters. The aim of this chapter is to demonstrate how this thesis has answered the research questions.

7.2 Summary of findings

Chapter 4 used the OECD publication where the Model Tax Convention is the main content, to analyse the legitimisation strategies used by the OECD. By looking at the introductory chapter to the publication which is written by the OECD itself, it was possible to detect the strategies used by the organisation. Due to the lack of discussion over *why* the Model Tax

Convention is the best model to construct taxation treaties from, and the focus on the Model Tax Convention as the obvious choice for decision-makers, it was deducted that the OECD has used cognitive legitimation strategies. The OECD has foregone important discussions and rather assumes that the Model Tax Convention is the most influential model. A particular way in which this is seen is through the way the OECD portrays the UN Double Taxation Model Convention. Rather than recognising that the UN Model was constructed due to dissatisfaction with the OECD Model, the OECD portrays this alternative model as a reproduction of the Model Tax Convention.

Chapter 5 looked at the reservations made by states towards the principle of taxing royalties exclusively in the state of residence, as advocated in the Model Tax Convention, and analysed reservations in terms of the independent variables. The OECD publication provides information on which states have chosen to make a reservation towards aspects of the Model Tax Convention and therefore has an intention not to adhere to this particular proposition. It was found that adherence to the Model Tax Convention is lower than expected, and also that states which are not members of the OECD are much less likely to adhere than member-countries of the OECD. Furthermore, I found that adherence to the Model Tax Convention can be best explained by the self-interests that states have in the propositions. The countries which gain the most benefits from adhering to the Model Tax Convention will do so, while states which benefit the most from alternative policies will choose not to adhere to the Model Tax Convention.

In order to get a more comprehensive picture of why states adhere to the Model Tax Convention, chapter 6 analysed a small sample of bilateral taxation treaties. This was done in order to further the understanding of how the Model Tax Convention is practically used and adhered to. The chapter found that taxation treaties are not reproductions of the OECD Model Tax Convention, but that they instead divert significantly from the propositions promoted here. Only one taxation treaty in the sample adheres to the Model Tax Convention's principle of exclusive taxation rights to the state of residence, while the remaining taxation treaties do not follow the principle but rather agree upon shared taxation rights between the state of residence and the source state. It was found that the most viable explanations for this trend were moral legitimacy and negotiation power. Although the 10% cap on tax rates on royalties in the source country reoccurred in many taxation treaties, the evidence was not strong

enough to conclude that cognitive legitimacy is the most important factor determining to which extent taxation treaties adhere to the Model Tax Convention. Instead the data material provided mixed evidence that states either respect the wishes of negotiation partners less developed than themselves, or that the state with the most power capabilities determine the outcome of negotiations. With the logic of the variables in question, one case cannot be evidence of both moral legitimacy and power as a factor, because they illustrate the opposite phenomena. While three taxation treaties illustrated negotiation power as the most important factor, two treaties pointed to moral legitimacy being the deciding factor.

Summarised the findings of this thesis point to the OECD using cognitive strategies to legitimate the Model Tax Convention. Adherence to the Model Tax Convention from the perspective of states is caused by self-interests when it comes to the decision of making reservations, and a mixture of moral legitimacy and negotiation power when it comes to determining the outcome of negotiations between states.

7.3 Implications of Findings

The findings outlined in the previous section have so far been treated as individual analysis and findings. However, this section will attempt to view the findings from this thesis together in order to demonstrate how the research questions tie together and have been answered.

The second research question asked why states adhere to the principle of exclusive taxation rights to the state of residence, but it might as well have asked what explains the level of adherence to this principle. At the outset of my work with this thesis I had an underlying assumption that states did in fact adhere to the principle of exclusive taxation rights to the state of residence particularly, and the Model Tax Convention generally. After having read about the Model Tax Convention and the OECD's work within international taxation issues, I had an assumption that this was the main model for taxation treaties, although this might not have been an entirely conscious assumption. When the research questions were formulated, it did not occur to me that states might not in fact adhere to the Model Tax Convention to the extent to which I assumed. This assumption strengthens the findings of chapter 4 that the OECD has used cognitive legitimization strategies, and is a demonstration that the strategy has

been successful. One of the main findings of this thesis is the realisation that the level of adherence, which has been formulated as the dependent variable of the research project, is in fact very low. Both in terms of the reservations states make towards the Model Tax Convention and in terms of the bilateral taxation treaties in the sample, the level of adherence is low. The unconscious belief that adherence would be higher which was developed before the analysis was executed may be a sign that the cognitive legitimisation strategies of the OECD has been successful when it comes to the literature and the reviews of the Model Tax Convention in the international community concerned with international taxation. It should be mentioned that the literature and the general knowledge of the taxation work of the OECD that the author read was mainly produced by states and organisations from OECD member-countries, as well as the OECD itself.

However, the analysis of the second research question has demonstrated that the cognitive legitimisation strategy by the OECD may not have been equally successful with regards to the states using the Model Tax Convention. The generally low level of adherence is a sign that states do not accept the Model Tax Convention as legitimate from a cognitive perspective. Particularly are states which are not members of the OECD sceptical towards the principle of exclusive taxation rights to the state of residence as advocated in the Model Tax Convention. It has been demonstrated that the way the OECD portrays the influence of the Model Tax Convention beyond OECD-membership is not in line with the findings of this research project, which has found evidence that non-OECD states do not accept the OECD's proposition. In my material, only the United Arab Emirates accept the principle of exclusive taxation rights to the state of residence without any reservations either full or partial.

The level of adherence to the Model Tax Convention seems to be determined primarily by self-interests, moral legitimacy and power. States that benefit from taxing royalties in the state of residence will adhere to the Model Tax Convention's principle without reservations, while states that do not benefit explicitly from taxing royalties in this manner will issue a reservation towards the principle. Furthermore, the state with the highest economic capabilities will most often have their preferences heard in negotiations over the content of taxation treaties, indicating more realist theories of international relations to be of importance. However, this finding is not compatible with the finding that also moral legitimacy seems to

be of importance in deciding the outcome from negotiations. Seen together, it seems like states will evaluate their opposing partner to the taxation treaty and act in different manners depending on which state they are negotiating with.

Although this has been a theory-guided study which has used theory to identify trends in the empirical material through the method of congruence, the findings discussed here have implications beyond the theoretical perspective. Finding that the OECD is using cognitive legitimisation strategies implies that states, scholars, tax authorities and courts of law should be aware that the perception of the Model Tax Convention they have, might be biased in the sense that it could be affected by the rhetoric of the organisation. Taking note of this potential bias may help actors gain an improved awareness of the Model Tax Convention, its importance and influence. Furthermore, in negotiations over taxation treaties with other states, states should critically evaluate the opposing party where there is disagreement over the content of the taxation treaty. If the opposing states have asymmetrical power capabilities one should be aware whether the other party is using its power to determine the outcome, or addressing moral concerns. The findings of this thesis demonstrate that a low income country might be able to influence the negotiations to a great extent if it chooses to emphasise the morality of a high income country giving concessions.

The introductory chapter presented one theoretical debate, and two empirical debates to which this thesis aimed to contribute. First, the debate on adherence to international standards, norms and rules is of increasing interests to the study of international relations. Finding out what makes states comply with standards or rules imposed on them from some outside entity has been debated vigorously among scholars, and the debate on environmental regimes was used as an illustrative example. This thesis has contributed to the debate through showing that states tend to comply with policies which corresponds to their own economic preferences. Furthermore, it has been demonstrated that in negotiations where there is asymmetry in interests and power, the state with the most power capabilities seem to determine the outcome of negotiations. However, despite the importance of interests and power, which are often related to the school of realism, moral legitimacy also seems to be of interests in determining outcomes. The fact that states do not follow the Model Tax Convention even where the

propositions satisfy their interests, but rather respect the preferences of states with lower economic capabilities than themselves, demonstrates the importance of moral considerations.

Empirically this thesis has contributed to the debate on international taxation and the role of institutions. By investigating the work of the OECD on the harmonisation of taxation on economic activity across borders, the thesis adds to existing literature by providing a thorough analysis of the Model Tax Convention and the taxation of royalties in particular. The focus on the OECD can be seen as part of a larger debate on the role of institutions in distributing resources internationally. Institutions as tools for distributive politics is a debate which often depends heavily upon the theoretical perspective from which the research is conducted. Realists are likely to discourage cooperation and instead promote the principle of self-help for each individual state. Liberalists are usually more enthusiastic about the role of institutions and focus on how cooperation might improve, while constructivists are often concerned with the norms that make cooperation emerge. However, I believe that this thesis has contributed to the debate on the role of institutions by investigating explanations derived from a wider spectrum of theoretical perspectives. By developing variables with foundation in all schools of thought, I have investigated institutions from a more eclectic perspective, and found that interests, power and morale influence how institutions are perceived.

7.4 Concluding Remarks

This chapter has provided a summary of this thesis and highlighted some implications of the findings. I have demonstrated how the findings have implications beyond the scope of this thesis and into academic debates. However, the discussions and results have opened up for possible further studies on the topic of the OECD Model Tax Convention and international taxation.

This thesis has used qualitative research methods. In answering the first research question alternative methodological approaches would be difficult and, I believe, not as fruitful in the sense that the subtle language nuances analysed here could not have been analysed in depth.

However, an alternative approach to answering the second research question would have been to create quantitatively coded variables to analyse adherence to the Model Tax Convention. Particularly, analysis of reservations to the Model Tax Convention can be coded easily, as demonstrated by the codings which were done in this thesis (Appendix 1). A statistical analysis of reservations, not just to the article concerning the taxation of royalties but to the remaining articles in the Model Tax Convention, could help shed light on the perception that states have of the Model Tax Convention, and could be useful in developing a deeper understanding of which countries make reservations.

A possible strengthening of the analysis of adherence to the Model Tax Convention might arise from a further investigation into the UN Double Taxation Model Convention. If the discussions in the UN result in a decision to include reservations to the Model, a comparison between the reservations made to the two Conventions would be a way to further investigate the nature of adherence to both Model Conventions.

This thesis has not analysed the aspect of behavioural power in negotiations, which it should be noted, may significantly influence the outcome of negotiations. The outcome of negotiations over taxation treaties may depend heavily on the personal capacity of negotiators. Due to the difficulty in achieving information about the negotiation process and dynamics, I have not had the opportunity to include this aspect in the analysis. Now that negotiation power has been identified as an important factor for determining why states adhere to the Model Tax Convention, this aspect may be interesting to consider in further research by looking at how individual negotiators and negotiation tactics may further influence outcomes. Analysing taxation treaties with the aspect of behavioural power as a factor for analysis may also be useful to understand the role of moral legitimacy versus the role of power in negotiations.

Lastly, the topic of international taxation is under-studied from the perspective of political science. The system of taxation was, as addressed in Chapter 4, created over a century ago, and the national focus of taxation may not be suitable for the multinational economy we see

today. Double taxation, as well as the emergence of double non-taxation should be a topic of study for political scientists in order to further our understanding of taxation systems and the interactions between these, the strategies companies use to get around these systems and remedies to create resilient and effective taxation legislation.

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Appendixes

Appendix 1: Reservations to Article 12

The tables presented in this appendix in the basis for tables 5.1 and 5.2. They are included in the appendix in order to get a full understanding of the reservations made towards Article 12, and how I coded these in advance of conducting the analysis.

The first coded column relates to reservations made towards paragraph 1 in which the principle of exclusive taxation rights of income from royalties to the state of residence is found. This column is the most important for the study conducted in this thesis, but in order to get a more comprehensive picture of the reservations made towards Article 12, some other codings have also been conducted. The second coded column also refers to the principle of exclusive taxation rights to the state of residence, but deal with smaller reservations i.e. not reservations to the entire paragraphs but aspects of it. For example, India does not reserve itself from the principle of exclusive taxation rights to the state of residence in general, but reserve the right to tax royalties deriving from technical assistance at source. The second paragraph of Article 12 defines royalties according to the OECD. The third column in the tables below is related to this definition, and indicates which countries choose to expand upon the OECD definition. The last coded column is related to the OECD Commentaries and indicate disagreement with the commentaries related to Paragraph 1. This column is coded positively for those countries which do not agree with the OECD's interpretation of the principle of exclusive taxation rights to the state of residence.

OECD states					
Country	Paragraph 1		Paragraph 2		Commentary
	Reserves the full right to tax royalties at source	Makes smallest reservations to the paragraph	Expands the definition of royalties	Disagree with aspects of the OECD commentary	
1 Australia	1	0	1	0	
2 Austria	0	0	0	0	
3 Belgium	0	0	0	0	
4 Canada	0	1	1	0	
5 Chile	1	0	1	0	
6 Czech Republic	0	1	1	0	
7 Denmark	0	0	0	0	
8 Estonia*	0	0	1	0	
9 Finland	0	0	0	0	
10 France	0	0	0	0	
11 Germany	0	1	0	0	
12 Greece	0	1	1	1	
13 Hungary	0	0	1	0	
14 Iceland	0	0	0	0	
15 Ireland	0	0	0	0	
16 Israel*	0	0	0	0	
17 Italy	0	1	1	1	
18 Japan	0	0	0	0	
19 Korea	1	0	1	1	
20 Luxembourg	0	0	0	0	
21 Mexico	1	0	1	1	
22 Netherlands	0	0	0	0	
23 New Zealand	1	0	1	0	
24 Norway	0	0	0	0	
25 Poland	1	0	1	0	
26 Portugal	1	0	1	1	
27 Slovak Republic	1	0	1	1	
28 Slovenia	1	0	0	0	
29 Spain	0	0	1	1	
30 Sweden	0	0	0	0	
31 Switzerland	0	0	0	0	
32 Turkey	1	0	1	0	
33 United Kingdom	0	0	0	0	
34 United States	0	0	1	0	
Total	10	5	17	7	

* Copied from the 2010 OECD Tax Model Convention, «Non-OECD Economies' Positions on the OECD Model Tax Convention»-section, because it became an OECD member after the publishing of the 2010 version

Table A1.1: OECD member countries' reservations

Non-OECD states					
	<i>Paragraph 1</i>		<i>Paragraph 2</i>		
Country	Reserves the full right to tax royalties at source	Makes smaller reservations to the paragraph	Expands the definition of royalties	Disagree with aspects of the OECD commentary	
1 Albania	1	0	1	0	
2 Argentina	1	0	1	1	
3 Armenia	1	0	1	0	
4 Belarus	1	0	1	0	
5 Brazil	1	0	1	1	
6 Bulgaria	1	0	1	0	
7 Croatia	1	0	1	0	
8 DR Congo	1	0	0	0	
9 Gabon	1	0	1	0	
10 Hong Kong, China	1	0	0	0	
11 India	0	1	1	1	
12 Indonesia	1	0	1	0	
13 Ivory Coast	1	0	1	0	
14 Kazakhstan	1	0	1	0	
15 Latvia	1	0	1	0	
16 Lithuania	1	0	1	0	
17 Malaysia	1	0	1	1	
18 Morocco	1	0	1	1	
19 People's Republic of China	1	0	1	1	
20 Philippines	1	0	1	0	
21 Romania	1	0	1	0	
22 Russia	1	0	1	0	
23 Serbia	1	0	1	1	
24 South Africa	1	0	1	0	
25 Thailand	1	0	1	0	
26 Tunisia	1	0	1	1	
27 Ukraine	1	0	1	0	
28 United Arab Emirates	0	0	0	0	
29 Vietnam	1	0	1	1	
	27	1	26	9	

Table A1.2: Non-OECD member countries's reservations

Appendix 2: Interview

This appendix is included in this thesis to account for the interview conducted in the research-stage of the project. The appendix only outlines the main interview conducted, and this was the only interview which took place under formal circumstances. The conversations held during the OECD Forum are considered to be sufficiently accounted for in the main text.

The interview object (IO) is a source at the Norwegian Ministry of Finance. The IO is part of the unit of the Ministry concerned with the taxation treaties that Norway has with other states, and is therefore well-informed about the preferences Norway advocate in negotiations with other countries and the process of negotiations. The IO also has a good understanding of the history of Model Tax Conventions – both the Model Tax Convention of the OECD and the UN Model Double Taxation Convention, and the work of the two organisations. The interview was unstructured in the sense that the interviewer came with a list of themes and open-ended questions rather than a structured list of questions. The interviewer had sent some information about the thesis and the project in advance, and the IO was prepared and started with a general account of the Model Tax Convention of the OECD and its influence. The interviewer only asked three open-ended follow-up questions which the IO spent considerable time answering in detail.

The project and the interviews have been reported to «Norsk samfunnsvitenskapelig datatjeneste AS» (NSD) and has been approved. All recommendations from NSD has been followed, and information about the project is available through the official database at: <http://pvo.nsd.no/prosjekt>